An Exploratory Examination into the Relationship between Corporate Governance and Risk Management in Islamic Banks: Disclosure and Survey Analysis

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By

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DECLARATION

I hereby declare that the materials contained in this thesis have not been previously submitted in application for another degree to this or to any other learning institution.

I further declare that except for those quotes, citations or references that have been duly acknowledged, this thesis is the result of my original investigation.

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Dedication

To my dearest children: Nazmi, Isyraf, Aizat and Shahnaz.

ACKNOWLEDGEMENTS

In the name of Allah, The Most Gracious, The Most Merciful. Alhamdulillah, all praises be to Allah, the most gracious and the most merciful. May His peace and blessings be upon our beloved Prophet Muhammad *Sallallaahua'laihiwasallam* and upon his family, his companions, and all his followers. My sincerest gratitude to Allah for all of his blessings through the various trials and tribulations I have had to undergo in order to finish this thesis.

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ABSTRACT

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Whenever corporate and financial failures and crises arise in the world, issues of corporate governance and risk management are always highlighted as major causes of the event. In order to substantiate such claims, it is first important to specify which factors, in either corporate governance or risk management, actually cause these failures. Furthermore, if such factors were identified, might these failures be avoided in the future? This line of questioning provides the rationale behind this research.

This study thus aims to explore and examine corporate governance and risk management practices as well as the potential relationship between the two variables in the case of Islamic banks in various countries. In doing so, the research explores corporate governance and risk management practices by employing disclosure analysis through annual reports, by using content analysis, with the objective of identifying the state of Islamic corporate governance and risk management practices in Islamic banks. To achieve this, the study analyses 181 annual reports from 53 Islamic banks. In addition, the corporate governance and risk management practices of Islamic banks were also explored through perceptions analysis, based upon the responses obtained by questionnaire survey from Islamic bankers and financiers from 28 Islamic banks from 6 countries and locations. An attempt was also made to locate the correlation between corporate governance and risk management with both data sets as it is expected that good corporate governance practices should moderate risk exposure and establish a better risk management process. Thus, this study is predicated on the notion that if banks have good corporate governance practices, the risk management practices should then be efficient.

By using qualitative and quantitative methods of data analysis, including correlation analysis, this study found that the relationship between corporate governance and risk management is not incredibly strong in the case of the Islamic banks involved in the period that this study covers. However, in examining the type of relationship, it was established that there was a positive relationship between the two. Thus, it can be said that with regards to bank failures, if corporate governance is the aforementioned trigger, it is also partly due to risk management – based on the fact that a positive relationship exists between the two. The findings of the study reveal two important results: corporate governance and risk management do not have a strong correlation between them. The findings show that most Islamic banks have very poor scores in Shari'ah compliance and Shari'ah governance. Poor scores are also revealed in other dimensions such as ethics, audit and board composition.

However, in determining which aspect of corporate governance has the stronger propensity for creating problems, it is important to establish the actual dimension which affects corporate governance and risk management the most. This study reveals that Shari'ah-related dimension has the highest bearing on the overall corporate governance positions. Risk management, on the other hand, depends very highly on reporting and disclosure.

A further aspect to consider is that not all dimensions positively affect corporate governance. For instance, the structure, committee and senior management has a negative impact on corporate governance. For risk management, all dimensions had positive impacts except for primary key areas, which are market and liquidity risk and operational risk.

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CHAPTER 1

INTRODUCTION

1.1. BACKGROUND

Corporate scandals and failures have now become a reality of everyday life. Despite the fact that they are triggered independently, they all still share similar elements in terms of sources and consequences. For instance, in general, they are all related to corporate governance and risk management issues (Lang and Jagtiani, 2010). This has led to an increase in the amount of academic literature on crises, examining the causes and aftermaths of financial and corporate failures in cases such as that of Parmalat, Enron, Barings Bank, Northern Rock, and the Lehman Brothers (Shin, 2008).

Many studies have examined these corporate failures in detail. For instance, Parmalat's scandal was associated with a conflict of interest between shareholders (Segato, 2005). The controlling shareholders had tried to extract private benefits at the expense of minority shareholders. Enron's failure, on the other hand, came from abusing accounting practices (Coffee, 2005) triggered by internal controls. The collapse of Enron proved a watershed in corporate governance when it filed for bankruptcy in 2001. Similarly, the Barings Bank scandal was a consequence of failures in its internal controls and was triggered by a rogue trader (Stein, 2000). The failure of Northern Rock may be seen as a result of the board and shareholders taking too many risks (Shin, 2009). In the same vein, the Lehman Brothers went bankrupt due to failures in the board, the senior management, and the risk management (Sikka, 2009).

Banks are vital in economic growth through their immense impact on the financial system (Demirgüc *et al*., 2013). When banks fail, they have very large impacts on the system (Haldane and May, 2011) compared to other non-banking corporations. The repercussions from their failures have an adverse effect on the country and public welfare at large. As is widely discussed in the literature, banks need to implement high quality regulations to ensure that the running of their businesses is aligned

between the banks' interests and that of their stakeholders. Thus, corporate governance as a form of regulation is required to act as a pedestal to ensure improved relationships with the banks' stakeholders and to enhance the quality of the rules and regulations.

Corporate governance (CG) and risk management (RM) have, thus, become increasingly popular areas of academic and professional research as they emerge in endless discussions following corporate failures. However, despite prolonged and protracted discussions, not much seems to have been done to ensure that financial crises and CG failures will not happen again.

All these corporate failures indicate corporate governance related problems, which also demonstrate how disastrous corporate governance and risk management can be if not well managed effectively and efficiently. In fact, it is because of these failures that the search has begun for alternative systems that can mitigate the risks inherent within the conventional system. For instance, Abdullahi (2013) claims that the current financial crisis has actually accentuated Islamic banking's position over conventional or interest-based banking system. This position is shared by Alzalabani and Nair (2013) who state that the resurgence of interest in Islamic finance has been triggered by the various global financial crises and economic recessions. In supporting this, Wilson (2008) posits that the collapse of leading Wall Street institutions, notably the Lehman Brothers, has encouraged a focus on Islamic banking and finance as an alternative model to the conventional one.

Nevertheless, it is important to note that, despite the crises occurring within the backdrop of conventional banking, corporate failures do not confine themselves to the conventional banking scene alone. During the early 2000s, a string of crises relating to Islamic finance lead the financial world to wonder what could have gone wrong in institutions where practices were based upon the moralistic principles of Islamic economics. Questions relating to the feasibility of the financial system spelt out by Islamic economics in accommodating to the modern world then found themselves being discussed. The failure of Ihlas Bank, an Islamic bank in Turkey, for instance, demonstrated that there were surprisingly weak corporate governance rules (Hasan, 2012).

Since Islamic finance is considered to provide a resilient base for preventing or mitigating the impact of corporate failures and financial crises (Chapra, 2008), it is essential that it should be explored. It therefore should be noted that Islamic finance in different forms and structures has been practiced since the prophet era. Literature records that Islamic finance was the dominant system before eventually being replaced by the conventional system due to colonisation and westernisation. However, it was not until four decades ago, in a banking system not attuned to the needs of the devout, that the IBF emerged, on a modest scale, to fill the gap of more Islamic methods of finance (Imam and Kpodar, 2010:6). According to Alzalabani and Nair (2013:16), while *Shari'ah* principles were used as the basis for a flourishing economy in earlier times in the history of Islam, it was only in the late 20th century that a number of Islamic banks were formed to apply these principles. According to Imam and Kpodar (2010), how fast the conventional financial system is to expand, Islamic finance, on the other hand, has not matched this pace as it only began three decades ago. Ullah (2007:11) mentions that the expansion of Islamic finance, after a few years, was expedited by the introduction of broad macroeconomic and structural reforms in financial systems, the liberalization of capital markets, and the privatization and integration of financial markets.

In view of this revival, it is expedient that a kind of enabling environment be implemented to help strengthen IFIs so that mainstream acceptance of Islamic banking may be obtained. However, this may be difficult to implement as it was not until recently that the corporate governance of Islamic financial institutions was thoroughly explored, despite the fact that corporate governance as a system of conduct is not particularly new to Muslim institutions and Muslim financial institutions. However, financial developments in the world have recently resulted in an increased attention to the Islamic perspective through a dynamic and wider corporate governance understanding. This stems from a series of corporate failures affecting the global financial system. Corporate governance has therefore become a more prominent tool in helping IFIs regain international acceptance.

In the modern understanding of conventional economics and economic policy, without indicating the objective of corporate governance, the definition, process, and substance of corporate governance is considered value neutral (Chapra and Ahmed,

2002:13). However, since developments in social theory inform us that social realities are socially constructed, therefore economic-related issues are thus also value-loaded. Thus, because it is derived from the *Quran* and *Sunnah*, Islamic corporate governance may have more objectives than mainstream corporate governance, and in certain parts, may have mandatory requirements placed upon it.

While perhaps the process can be similar in Islamic and conventional corporate governance, the substance of the two may differ, as Islamic corporate governance has an outer layer called '*tawhid*' which dictates the corporate governance framework's operations. As mentioned by Tapanjeh (2009:556), Islamic corporate governance cannot compartmentalise the roles and responsibilities in which all actions and obligations fall under the jurisdiction of the divine law of Islam. Nevertheless, Islamic corporate governance has more obligations compared to mainstream corporate governance (Chapra and Ahmed, 2002).

The main concern of Islamic corporate governance is to fulfil responsibilities and take care of mankind's welfare with aims being essentially to enhance the ethical operations of Islamic banks (Slahudin 2008) and other organisations.

However, it is important to note that, apart from achieving *Shari'ah* objectives, Islamic corporate governance also shares certain principles with mainstream corporate governance. For instance, effective corporate governance helps mitigate the effects of adverse managerial behaviour. In terms of management, corporate governance provides a better structure and allows for more efficient resource allocation (Claessens, 2006). Because of corporate governance, access to financing is made easier (Hoque *et al*., 2013), thus encouraging investment, leading to more employment and thus more economic growth. Furthermore, good corporate governance also helps make banks more credible (Levine, 2003) by helping it to attain higher market confidence.

Countries with a good corporate governance system often have strong corporate growth and are better able to attract investors (Slahudin, 2008). Corporate governance also encourages businesses to create better working environments to increase investment. By reducing costs of financial intermediation capital, corporate

governance also helps banks get better returns, and thus allows them to be more competitive.

As a discipline, corporate governance guides business conduct and shapes future strategic direction. It plays an important role in ensuring efficient financial systems by improving the running of business operations, putting an effective decision-making process in place, whilst also taking care of the stakeholders' interests. A well-managed corporation is often associated with good corporate governance, which then ensures the better performance of the entity. On the side of consumers, good corporate governance increases a bank's efficiency, thus enabling the bank to provide them with better access to financing. Furthermore, an improved operating environment leads to increased performance thus improving efficiency. By and large, corporate governance can thus be said to help achieve systemic stability in the corporate sector and financial system as a whole.

Nevertheless, with the news of scandals associated with certain high profile companies in recent years, it may be the case that corporate governance alone is insufficient to guarantee the health of the financial system. In recent years, the world has been confronted with numerous catastrophes when development in the global financial system was interrupted by a wave of crises. Incidents such as the collapse of a number of banks impacted the economy and public welfare globally, not only in their specific countries. A failure in one bank causes ripples within the stock market which then spread across the world (Acharya *et al*., 2010).

The occurrence of bank failures puts the bank's reputation at risk, resulting in thinner public confidence with the bank. Consequently, banks eventually face liquidity risk as they have constraints in lending, which affect the public at large and eventually affect investments. A lack of investments leads to lower production resulting in lower productivity and slower growth. Literature asserts that had there been effective risk management in place, this may have helped the banks mitigate the financial risk.

Thus, risk management is an important element to firms (Drennan, 2004) as it prevents excessive risk-taking. From the Islamic perspective, the increase in the number of Islamic banks as well as the participation of conventional banks in Islamic banking has heightened competition in Islamic banks. In order to stay competitive,

many Islamic banks have adopted corporate governance to work hand-in-hand with risk management. As highlighted by Asutay *et al*. (2010), in indicating the breadth of current Islamic finance practice, its risk management including *Shari'ah* risk, *Shari'ah* governance, and *Shari'ah*-compliant investment should be developed. On another note however, there has not been much discussion in literature that clearly spells out the line between risk management and corporate governance.

In Islamic corporate governance, there are additional characteristics of risk management that need to be fulfilled in order to adhere to the *Shari'ah*. These include: proscribing the transfer of risk to another party, disallowing excessive risk-taking, and prohibiting uncertainties such as gambling (Ayub, 2009). Factoring in all these characteristics, risk management fits in well with Islamic corporate governance of which both are based on the same foundations, *i.e.* '*tawhid*', which essentialises every component in life as part of the same order and interacted manner with responsibilities towards each other. In principle, risk management, thus, acts as both the foundations of internal control and corporate governance, which functions to control operations and risk exposure through a process by which risks are identified, mitigated, controlled, and monitored.

Risk management plays its roles by controlling and monitoring the banks' operations and restraining the management's expropriating behaviour, which should, therefore, be considered as another type of corporate governance mechanism (Fischer, 2008). Following on from that, corporate governance can be classified into two types of mechanisms called internal and external mechanisms (Denis, 2001). The internal mechanism mainly comprises the board and senior management while the external mechanism involves regulations, audit, risk management, and financial reporting which controls managerial behaviour. Risk management and regulations are part of the external mechanism of corporate governance.

With good corporate governance, banks can be more prudent in their risk-taking activities. For instance, looking briefly at the case of Barings Bank, United Kingdom (1995), it can be seen that the scandal was the result of excessive risk taking (Tickell, 1996). Poor governance, and a poor understanding of how the senior management undertook its procedures caused huge losses to the bank. Had the bank adhered to *Shari'ah* principles in its risk management, the financial disaster could have been

mitigated or the impact could have been moderated. This is due to the fact that risk management is done more stringently under *Shari'ah* principles.

Islamic banks must be more careful in evaluating risks (Ayub, 2007), as they have additional risks due to the risk sharing nature of Islamic finance (Ahmed, 2009). Furthermore, by adopting Islamic corporate governance, failures can be reduced because every single aspect of the bank's governance is taken care of by a framework that embraces and upholds *tawhid*, the utmost comprehensive layer of governance. Thus, issues of mismanagement such as being overly dependent on one staff and unethical working practices when unsupervised, among other issues, may not have surfaced in the first place.

Both corporate governance and risk management are deemed important due to their accountability in serving the public. Normally, a well-managed company has good corporate governance achieved through an effective risk management function. In recent years, enormous losses have been recorded as a result of corporate failures due to the management's behaviour in excessive risk-taking. To reduce the potential for such loss, improved corporate governance through risk management functions such as controlling managerial behaviour has clearly become important for banks.

Corporate governance is used to moderate bank risk-taking through the imposition of restrictions on the management (Gompers *et al*., 2003), as good corporate governance, through risk management, ensures that the management allocates the appropriate controls before making decisions on risk-taking. Fischer (2008), therefore, mentions that internal risk management should act as the first line of defence for financial systems. As interested parties are concerned with how risk exposure is distributed, internal control, which is part of the risk management process, puts measures in place to help safeguard assets and reputation. Thus, it is through good corporate governance and appropriate risk management structures that banks attain their efficiency and effectiveness.

Grais and Pellegrini (2006) state that as IFI assets continue to expand, Islamic corporate governance will have an important role to play. It is hoped that Islamic corporate governance might solve the principal-agency problem. Besides that, Islamic corporate governance also protects stakeholders (Grais and Pellegrini, 2006).

As for the relationship between corporate governance and risk management practices, in the initial analysis they seemed to be correlated. Thus, with respect to corporate failures and financial crises, CG and RM always find themselves being scrutinised from all angles. People lament on questions such as: what the board did, how good the risk management is, how internal controls are implemented, the ownership structure, the performance of the institutions, and many more such questions. However, nothing is ever mentioned with regards to the connection between CG and RM. It may very well be possible that there exists a relationship between CG and RM, that an effect on CG will also cause something in RM. The possibility exists that an inadequacy in RM could be reflected in CG. Conversely, rectifying inadequacies in CG may also improve RM. Could the answering of these questions help mitigate the effects of crises? Somehow, it is felt that such answers may hold the key in giving a tentative direction towards identifying important issues with regards to the crises.

When discussions are held, quite often it is implied that CG incorporates RM. In many instances, CG is almost always related to the board. There are also occasions that CG is seen to encompass RM. However, nothing has been found so far that gives a clear indication as to the scope of CG and what specifically categorises issues as belonging to either CG or RM. This, together with corporate governance and risk management practices, is the subject matter of this research.

1.2. RESEARCH AIM AND OBJECTIVES

This study aims to explore and evaluate the corporate governance framework and risk management practices of Islamic banks through disclosure and perception analysis, which also aims to explore and examine the potential relationship between the two through statistical analysis.

This research, hence, examines corporate governance and risk management practices in Islamic banks through unobtrusive research based on disclosure analysis and also through the perceptions of Islamic bank employees. Whilst doing so, the participants' perceptions on both corporate governance and risk management are compared against what is communicated by the Islamic banks through annual reports.

In fulfilling the identified aims, the following objectives are developed:

(i) to study corporate governance and risk management theories and theoretical frames and model in Islamic banking through the established literature;

(ii) to develop indices for good corporate governance and efficient risk management practices through which to evaluate the practices of the sampled Islamic banks;

(iii) to explore and examine corporate governance and risk management practices of sampled Islamic banks through an unobtrusive research based on annual reports of the sampled banks with the help of disclosure analysis;

(iv) to explore and examine corporate governance and risk management practices of sampled Islamic banks through a questionnaire survey conducted with the relevant staff of Islamic banks;

(v) to examine the corporate governance framework in specific manner with regards to how it relates to the specific risks of the banks;

1.3. RESEARCH QUESTIONS

The study aims to answer the following research questions based on a gap analysis derived from literature reviews. In line with the research aim and objectives, the research questions are formulated in order to give direction to the research. Analytical responses to each of these questions are provided through a qualitative and quantitative analysis of its associated empirical results in the later chapters. The research questions are as follows:

(i) What are the main distinctive features of corporate governance in Islamic finance?

(ii) What are the main distinctive features of risk management in Islamic finance?

(iii) What form of relationship exists between the corporate governance framework and risk management adopted by the Islamic banks?

(iv) What form of relationship exists between each dimension of corporate governance framework and risk management adopted by the banks?

(v) To what extent does the corporate governance framework affect risk management in Islamic banks and *vice versa*?

1.4. SCOPE OF RESEARCH

Focusing on corporate governance and risk management, this research is confined to Islamic banks and institutions that offer Islamic financial products and services. It is a study conducted specifically on IBs sampled from Bahrain, Bangladesh, Egypt, Indonesia, Jordan, Kuwait, Malaysia, Oman, Pakistan, Qatar, Saudi Arabia, Sudan, Turkey, UK and Yemen.

The research explores the corporate governance framework from the *Shari'ah* perspective by examining every aspect of corporate governance such as the board, the committees and senior management, the act and regulations, as well as the support and operations functions. Similarly, the study also explores the risk management practice of the IBs so as to analyse how the latter relates to the corporate governance of the respective banks.

1.5. SIGNIFICANT CONTRIBUTION OF THE RESEARCH

In view of a lack of intensive and in-depth research in the areas of corporate governance and risk management with regards to Islamic principles, this research is an attempt at studying the relationships between these two nexus in Islamic banks. As no work has been located that sufficiently explains the relationship between corporate governance and risk management theoretically and empirically, the attempt presented in this study should be considered an original attempt.

The literature indicates that there are studies on the corporate governance performance mainly specialised on *Shari'ah* governance issues and also on a number of empirical and discursive studies in risk management in Islamic banking. However, there is no other study identified in the Islamic finance literature that focus on the state of corporate governance and risk management practices and also the potential relationship between the two. Having two types of data sets and using extensive qualitative and quantitative methods in responding to the identified research questions (as above and in Chapter 1) this should also be considered an area of significant contribution of this study.

This research, thus, is an empirical study of corporate governance in relation to the risk management practices of Islamic banks. An extensive review of the literature did

not indicate the availability of any papers on the subject matter in Islamic finance while similar studies were scarce in conventional finance as well. Thus, this study should be considered as a novel and humble contribution to the available body of knowledge. This novelty is also its strength and significant contribution in terms of it being an empirical study in the field, something which has not been explored until this study.

Based on the primary data and secondary data that was collected through surveyed questionnaire and the disclosure approaches (from the sampled countries as mentioned above), the findings indicate that corporate governance in Islamic banks is associated with the banks' risk management. The findings from both the approaches reveal that there are positive relationships between CG and RM with an indication of relationships between CG and RM. The results also revealed that there are certain dimensions in CG and RM that affects the CG framework and RM practices. For instance, '*Shari'ah* compliance' and 'supports and operations' are very important dimensions in CG from the questionnaire and disclosure approach respectively while 'reporting and disclosure' and 'general risk management (practice)' are the most influential dimensions in RM based on both the questionnaire and disclosure approaches respectively. Thus, the significant contribution of this study is mainly in the empirical evidence produced in the case of Islamic banking on this topic.

Even though some of the principles of corporate governance and risk management in the conventional banks are shared with the principles outlined by the *Shari'ah*, mainstream banks do not have extended obligations similar to those in Islamic corporate governance and risk management so the findings may only hold in the case of Islamic banks.

1.6. RESEARCH METHODS

In responding to the research questions, this study adopts a qualitative research methodology as it examines CG and RM based on how they are conveyed by human behaviour. In operationalizing it, the research uses a combination of research approaches: explorative and descriptive. The explorative approach is used due to its nature in exploring the various frameworks of CG and RM while the descriptive approach is used as this design provides a snapshot of thoughts which can be based on

surveys. In essence, this research is a qualitative research as it attempts to gauge feedbacks which are qualitative in nature (with regards to CG and RM relationship based on the respondents' perceptions which will be explained further in Chapter 5). However, the research is also a quantitative in nature as it quantifies qualitative data.

The research utilises both the primary and secondary data in the analysis, gathered through survey questionnaires and a disclosure approach respectively. The primary data was obtained from a collection of a sample of 28 IBs from six countries while the secondary data was collected through 181 annual reports from 53 IBs from 15 countries (as mentioned above).

1.7. AN OVERVIEW OF THE RESEARCH

The paper has eight chapters, which are structured as follows:

Subsequent to this chapter, Chapter 2 provides insights into the literature review. It reviews existing literature, text, and other relevant reference materials of corporate governance from both perspectives, *i.e.* from Islamic and mainstream perspectives. While providing an overview of corporate governance based on its concept and definitions, the chapter also tries to compare the models adopted in both perspectives. Beyond that, the chapter also briefly discusses the theoretical aspects of corporate governance in trying to provide a foundation to the models adopted by corporate governance. It also discusses some leading theories that underlie corporate governance structures while presenting some familiar models adopted by banks in various parts of the world.

Chapter 3 presents the literature review on risk management. This chapter discusses risk management in both Islamic and conventional banking. While providing an overview of the risk management concept and its definitions, the chapter tries to compare the types of risks in both perspectives. In addition, this chapter also briefly highlights some issues faced in the implementation of risk management in IBs.

Chapter 4 deliberates on the research strategy and methodology adopted for the data collection process. This chapter presents in detail the recommended research procedures by making reference to research methodology textbooks on the appropriate research processes and techniques to be used. The rationale and

justifications for each of the tools and techniques used throughout this study are also highlighted. In addition, the chapter provides a refined outline and worksheet to help with analysis in the empirical and statistical chapters.

Chapter 5 provides a descriptive analysis of the findings based on a disclosure approach. In trying to identify the level of corporate governance and risk management practices of the IBs, the chapter employs statistical measures such Spearman's rho and Pearson Correlation (using the SPSS software) to test for correlation. To further analyse the results, the strength of dimensions on the overall CG and RM were examined. The chapter employs tools such ANOVA and the Regression Coefficient to provide a more meaningful results.

Chapter 6 presents an empirical analysis of the survey outcomes. In this chapter, the perceptions of the respondents are examined by analysing the outcome from the survey questionnaires. The chapter also provides the profiling of the respondents involved in the survey to gauge whether there are any contributing factors that influence their perceptions. This chapter employs tools such as the Kruskal-Wallis tests to examine the results. The data is also examined using ANOVA to provide meaningful results on the regression analysis.

Chapter 7 concludes the study, which contextualises corporate governance in relation to risk management. It provides a summary of the major findings from the two approaches: the disclosure approach from annual reports and the perception approach from the questionnaires. Having presented and discussed the empirical and statistical findings in Chapters 5 and 6, which correspond to each of the research methods laid down in Chapter 4, Chapter 7 provides a contextualised summary discussion of the findings. It also makes cross-references to the theory and findings of previous studies in order to link all pertinent outcomes in this study together. In its attempt to offer suggestions for future research, it highlights the limitations of the study before offering recommendations. The outcome of this chapter gives some insight into deriving the overall conclusions of the study.

CHAPTER 2

CORPORATE GOVERNANCE IN CONVENTIONAL AND ISLAMIC PERSPECTIVES: PARADIGM, CONCEPT AND OPERATION MECHANISM

2.1. BACKGROUND

Recent financial crisis have brought increased interest into the field of corporate governance (CG), as it plays a vital role in the economy due to its essence and determining nature of the working mechanism of the financial system as well as corporate sector. This is due to the fact that it determines the behaviour of corporations in achieving corporate goals, thus affecting their performance. Due to the increased interest, consequently, many studies on corporate behaviour have been vigorously carried out.

This chapter, hence, explores alternative perspectives on CG by comparing the conventional and Islamic model of CG; they are subsequently explored and discussed in Part 1 and Part 2.

Part 1 comes in three sections. Section 1 introduces CG through some definitions to describe some conceptions of CG. This is followed by the theoretical frameworks of CG, which discusses about theories and issues. Finally, some CG models adopted by countries are described.

Part 2 is outlined in four sections. Section 1 presents the background of Islamic moral economy to unveil the evolvement of Islamic banking through the history. Then, Section 2 discusses the theoretical framework of Islamic moral economy from the *Shari'ah* principles. Section 3 presents how Islamic moral economy is contextualised into CG. Section 4 sets forth the axioms that hold the pillar of CG from the Islamic perspective to rationalise how Islamic Corporate Governance (ICG) works in the context of Islamic banks. Finally, this is followed by a concluding remark to end the chapter.

2.2. CONCEPTUAL DEFINITIONS OF CORPORATE GOVERNANCE

Ever since CG became prominent during the 1980s, definitions have emerged from many sources such as theorists, academics, economists, and *etc.* Inevitably, CG is observed from many perspectives; thus definitions have been very diverse and any stereotypical patterns or conceptualizations of the definitions have been distinctive and are subject to the nature of reasoning in defining CG. This depends on the position and disciplinary background of the individual rendering the definition (Clarke, 2011) and a respective perspective, then, affects the particular way CG is applied. As Monks and Minow (1995) observes that CG definitions are often affected by the biases of those giving the definitions. Turnbull says that, "The various views on corporate governance can also be related to different cultural contexts, intellectual backgrounds and interests of scholars" stemming from "different academic disciplines." Thus, "there is often little, or incomplete, integration between various disciplines" (Turnbull, 1997:184) in providing a definition for CG, as in other social science related concepts.

Since definitions of CG often differ in various ways, simple generalisations of CG are difficult as inexhaustible definitions of CG exist in literature. One widely used definition is given by Cadbury (1992), which views CG as a system of control. In other words, Cadbury (1992) sees CG as trying to balance social and economic objectives while simultaneously being a structure promoting efficiency and accountability. Similarly, McRitchie (nd.:para. on McRitchie) sees CG as both the structure and relationship which directs the corporation and determines its performance. Thus, the definitions take the board as the centre where its relationship to other primary participants is critical. This mirrors Cadbury's definition, as CG is highly related to the board of directors. Likewise, Turnbull (1997) sees CG in the context of the board's structure and function. From a broader perspective, Monks and Minow (1995) base their definition on relationships, focusing on corporations that do not perform well, as, to them, CG may be defined as the affairs of the whole company and not just the board.

CG may be seen as a discipline which looks at how incentives affect management, specifically in the sense of financial performance. On a similar note, Wójcik (2002) views CG from an investment perspective. In the narrow sense, he agrees with

Shleifer and Vishny (1997:738) who state that "corporate governance deals with the ways in which suppliers of finance to corporations assure themselves return on their investment". In the broader sense, he agrees with O'Sullivan (1998:1), who views it as "concerned with the institutions that influence how business corporations allocate resources and returns. Specifically, a system of corporate governance shapes who makes investment decisions in corporations, what types of investments they make, and how returns from investments are distributed".

In further exploring the concept, Okabe (2004) views CG from two perspectives. First, he views CG as a framework that allows shareholders to supervise management. He calls this a 'finance approach', as it is the corporate fund providers' authority; or an 'agency view', since it regards managers as agents who manage the company for shareholders. This is similar to Wójcik's (2002) narrow definition of CG. Alternatively, Okabe (2004) relates the behaviour of corporations to CG as a relationship in which competing interests are elaborated upon by stakeholders. He regards this later view as a "stakeholder view" as he believes that firms with the structure of authority, responsibility, and interaction among them belong to all stakeholders.

Similar to previous definitions, Monks and Minow (1995) defines CG through an administrative viewpoint when he perceives CG as being how companies are directed. He sees good governance as essential to corporate success and sustainable economic growth. In this definition, a corporation exists as a structure allowing parties to collaborate and contribute capital to benefit others. According to him, research in CG is an interdisciplinary topic, which draws primarily from economics and law, and an understanding of business practices stemming from empirical studies in different national systems.

Claessens (2006) defines CG as the relationship between the shareholders, directors and management of a company, as defined by the corporate policy. Thus CG is the set of obligations and decision-making structures that shape the complex set of constraints that determine the profits generated by the firm.

In providing an integrated definition, Blair (1995) states that CG is about the arrangement in terms of legal, cultural and institutional which spell out the

corporations' actions, the allocation of risks and return. This coincides with the view that CG is a system of management. By adopting a consequential approach, Gourevitch and Shinn (2005) claim that CG structures are the result of political decisions.

In providing an organisational perspective, Arrow (1974) views CG as starting with an organisation with common objectives. He regards each member as having different goals which are not necessarily in line with the organisation's objectives. He views that not all corporate or external information is shared among members.

Meanwhile, Cochran and Wartick (1988) conceptualise CG from two approaches. They view inconsistencies between practice and the ideal with regards to the management's interactions with stakeholders. Beyond that, they also suggest that CG may be conceptualised through an understanding of CG's fundamental issues, namely the separation of ownership and control as well as clarifying the difference between governance and management. This leads to associated theories of CG, as explored in the following section.

2.3. THEORIES AND MODELS OF CORPORATE GOVERNANCE

This section aims to survey available models of CG in existing literature, which is preceded by theories associated to CG.

2.3.1. Agency Theory

Agency theory revolves around issues of separation of ownership and management. Its deals with conflicts of interest (Shleifer and Vishny, 1997) triggered by individuals[1] increasing personal wealth at the expense of the principal, usually by committing moral hazards (Tricker, 1994). Accordingly, agents usually abuse power do not perform in the best interests of the principal (Jensen and Meckling, 1976), and may shun decisions that profit the firm as such decisions are made selfishly (Tricker, 1994).

Fama and Jensen (1983) state that agency theory assumes agents do not own resources; rather, they control the company using their skills. According to Donaldson

[1] with different goals

and Davis (1991), agents' actions do not follow those needed to maximize shareholder returns. However, Amihud and Lev (1981) state that agents are incentivised to pursue strategies that reduce the risk of employment, due to adverse selection that follows through from asymmetric information. Thus, Buchholtz (2001) highlights that asymmetrical power distributions may make firm owners engage in exploiting subordinates. This leads to what Williamson (1985) views as opportunistic managerial behaviour.

Alternatively, agency theory may not necessarily be triggered from the economic perspectives alone but also from finance, management, and other perspectives. Eisenhardt (1989) supports this by claiming that the theory sees use in many fields and views it through a spectrum of risks, *i.e.* through the principal-agent relationship that cooperates with different objectives and views on risk.

The literature sees agency theory from both formal and informal perspectives (Kochhar, 1996). "Much of the formal agency literature is concerned with issues of efficient risk bearing" (Williamson, 1988:568). Normative principal-agent literature, which outlines compensation contract design, is linked to optimum risk-sharing properties (Levinthal, 1988). On this, Beatty and Zajac (1995) note that organizational research using agency theory from the normative agency literature is lacking. They mention that the alternate and less formal perspective of empirically-based agency literature focuses on the separation of ownership and control and the role boards play as stated by Fama and Jensen (1983), Weisbach (1988), and Morck *et al*. (1989). As for Fama and Jensen (1983), their concerns are on techniques of monitoring and bonding the contract and organisation.

In providing management and business perspectives, Donaldson and Davis (1991) see agency theory as being an influence to strategic management and business policies. Ross (1973), Jensen and Meckling (1976) and also Beatty and Zajac (1995) identify that agency theory is related to issues of CG and executive compensation.

Agency theory assumes market efficiency to locate the optimal contract for the exchange and focus on managing the appropriate contracting actions, thus ensuring compliance and preventing moral hazards (Kochhar, 1996). From a risk perspective, Eisenhardt (1989) claims that it is difficult to monitor an agent unless the appropriate

governance structure is present. She believes that, in agent behaviour, the different risk appetites and preferences of the agent and principal contribute to conflict.

Tricker (1994) observes that agents and principals often have incomplete contracts due to principals using ex-ante incentive instruments to overcome moral hazards. However, it is impossible to avoid moral hazards by using contracts as they are unenforceable (Tricker, 1994). However, based on the principal-agent arrangement, contracts may, at the very least, specify circumstances where managers can be replaced or assets purchased. Chakrabarti (2005) views that it is impossible to create a comprehensive contract which outlines every possibility as they are only able to specify why managers must be given pay related to performance.

Agency problems trigger agency costs (Monks, 2011), *i.e.* costs incurred to in the supervision of management, which comprises monitoring expenditures; bonding expenditures[2], and residual loss[3] (Jensen and Meckling, 1976). Agency theory uses check and balance systems with risk bearing procedures to reduce costs (Eisenhart, 1989).

It should be noted that, according to this theory, a compromise exists between incentives and risk sharing. The neoclassical theory assumes the significance of effort and cost, thus agency problems are required to balance efficiency and risk bearing. Alternatively, if agency problems are not taken into account, maximizing profit or minimizing cost may be performed by anyone so long as such efforts are compensated (Eisenhart, 1989).

Besides giving rewards to managers to incentivise the maximisation of returns, agency costs also include methods of linking compensation and shareholder benefits (Eisenhart, 1989). However, as much as high incentives may work as motivation, low incentives should also be given to avoid too much risk-taking (Eisenhart, 1989). Thus, Eisenhart (1989) views that firms should provide balanced incentives for the management (as performance is linked to the management's efforts) in order to

[2] Bonding costs happen when agents spend resources to avoid indirectly harming the principal.
[3] Residual loss is the main element which principals want reduced (Williamson, 1988). It occurs when the firm's value is reduced, *i.e.* when ownership is diluted or when shareholder returns are below expectations.

effectively realise firm profits. To decrease conflicts, debt is often used to lessen agency costs. Agency costs are also exacerbated when free cash flows in the firm, and this can be mitigated by limiting the amount of free cash flow to managers (Kochhar, 1996).

It should be mentioned that due to its nature, agency theory finds the most use in countries where the legal systems have been long entrenched, such as in the US and UK. It is favoured by shareholder theorists as it recognizes shareholder rights and protects minorities and shareholders which are diversified. However, agency theory tends to see man as a form of homo-economicus, which "depict subordinates as individualistic, opportunistic, and self-serving" (Davis, 1997:20), which then sees itself as becoming the main problem of CG.

On another note, Donaldson and Davis (1991) who do not agree with agency theory posit that managers are not self-serving and actually work to benefit shareholders.

2.3.2. Stewardship theory

With roots in psychology and sociology, stewardship theory sees relationships from the perspective of behavioural patterns (Kluvers and Tippett, 2011). It deals with the relationship between the management and the principal when both their interests are compatible, while also assuming that shareholders and managers are synchronised. Stewardship theory opposes agency theory's predictions on the structure of the board (Muth and Donaldson, 1998). It regards man as trustworthy, and therefore assumes managers as stewards. Therefore, the theory suggests that individuals are motivated to work to benefit the principal and also assumes that there are no problems with regards to motivating executives (Donaldson and Davis, 1989).

Stewardship theory assumes that managers look to increase the performance of their organisations (Fox and Hamilton, 1994), as they are seen as striving to bring about large profits and shareholder returns. According to Donaldson and Davis (1994), managers require responsible work and thus it is in the best interests of organisations to give managers a mostly free rein. .

Alternatively, Donaldson and Davis (1989) indicate that using non-executive boards as a moderation tool is not effective. They view that the board loses relevance once

there is a dominant and active shareholder, especially when that shareholder has vested interests elsewhere such as being family or being from the government. Pfeffer (1972), meanwhile, sees external directors as affecting the firm's constituencies more than the managers. He found that industries with high regulation usually have board with greater amounts of outsiders.

Tricker (1996) points out that directors must demonstrate their fiduciary duty to shareholders as part of the law. Within this idea of fiduciary duty lies the notion that directors are trustworthy stewards for the company (ibid.). This means that they are required to act on par with the principal as opposed to simply acting on behalf of the principal (Tricker, 1996).

It should be noted that Tricker (1994) sees influential supervisory advisors as prevalent in Anglo-based cultures. Ghoshal and Moran (1996:14) opine that agency theory "can become a self-fulfilling prophecy whereby opportunistic behaviour will increase with the sanctions and incentives imposed to curtail it". According to them, the same is also true of stewardship theory.

Similarly, Donaldson and Davis (1994) see managers as good stewards who work in order to benefit the corporation and the shareholders.

Changing business environments thus require corporations to change their focus away from profit maximisation and recognise that shareholders and stakeholders are both integral to corporate success.

2.3.3. Stakeholder theory

Stakeholder theory describes organisational management and ethics (Phillips *et al*., 2003). It is responsible for other constituents, and as such Friedman (1963) tries to split stakeholders into two categories. According to one definition, stakeholders represent those that have an effect on, or are affected by, achieving the organisation's goals. In the other definition, stakeholders are individuals integral to the organisation's survival (Mitchell et al., 1997: 857).

Clarkson (1994), on the other hand, defines stakeholder theory by looking at firms as systems of stakeholders which work within a society that provides the appropriate

infrastructure for their activities. From this, he also states that firms are aimed at creating wealth for stakeholders. Similar to Clarkson, Blair (1995) also sees the goal of management to be wealth maximisation. This can be done by allowing for ownership-like incentives to harmonise outside interests with stakeholder interests.

Whether or not firms should take care of both stakeholder and shareholder interests is a controversial matter. Traditional theories of the firm require that all stakeholders be taken care of. Most other theories are based upon corporations trying to benefit more than just shareholders (Carrillo, 2007).

Stakeholder theory emerged due to convergence, which in turn arose from globalisation. The internationalisation of capital markets itself has thus made stakeholder theory more attractive to firms. The theory has subsequently grown in popularity alongside business ethics as evidenced after the spark of many conglomerate failures.

Stakeholder theory supports most European models and is practiced by a majority of European countries such as Germany, France, Italy, Spain, and Greece (Jurgens et al., 2010). It can be seen from many perspectives such as economics, law, business, philosophy, ethics and management.

Controversies arise when stakeholder theory is used to balance stakeholder interests. This is because stakeholders often have interests which conflict (Jensen, 2002). Thus, Bowie (2002) views that stakeholders need not be placed on equal pedestals and instead sees the need to take care of relevant stakeholders as a moral obligation.

With regards to morality, Bowie (2009) links stakeholder theory with corporate social responsibility, seeing successful firms as being the result of an environment which is moralistic in relation to human rights and society. He believes balance to be a problem as balancing all stakeholders' interests makes stakeholder theory unrealistic. Van de Ven (2005), however, is keen to balance all stakeholder interests as he views that corporations are morally obligated to provide returns to stakeholders.

On another note, shifts in business have also contributed to the acceptance of stakeholder theory. As Clarke (1998:183) says, "The attenuation of shareholders' roles in managing business and the rise of professional management is associated with

growing recognition of the significance of the role and the contribution of other stakeholder groups to the performance of the company".

Jensen (2002) claims that stakeholder theory leads to an increase in agency costs. However, lacking any performance criteria, it is impossible to judge managerial performance effectively. Thus, Jensen does not view stakeholder theory as being particularly useful compared to value maximisation and posits that the theory is inaccurate and does not detail the purpose nor objective of the corporation, which may lead to conflicts. Thus, other alternatives need to be found.

2.3.4. Transaction Cost Economics

Transaction cost economics (TCE) is derived from the disciplines of law, economics, and organisations. As widely mentioned in the literature, TCE focuses on the governance of contractual relations in transactions between two parties. Two streams of TCE exist, one related to measurement and another related to governing contractual relations (Kochhar, 1996). Thus, it is a theory which debates upon the choice between hierarchy and market. The theory is related to research regarding governance structures. Williamson (1996) defines governance structures to be systems in which transactional integrity is determined, while also noting that such governance regimes also help dictate rules which help perform transactions cost-effectively. Thus, TCE makes the assumption that opportunistic actors will make the rational choice of a governance structure in which separate individuals will have differing information (Minnaar and Vosselman, 2009).

Exchange costs may be reduced by matching TCE with transactions (Kochhar, 1996). According to Goldberg (1985), different structures of governance have varying transaction cost levels. As this theory sees firms as the centre of contracts, it tries to find the most cost-effective method to undertake transactions within the firm. This model, thus, relies on the notion that contracts are inherently incomplete and that models serve only as a governance structure for the sole purpose of decision making.

Stiles and Taylor (2001) claim that TCE and agency theories are problematic in relation to the discretion of managers. They claim that, with boards being relegated to control mechanisms, managers act selfishly and tend to sacrifice profits for personal gain, thus not acting in the shareholders' best interests.

2.3.5. Class Hegemony and Managerial Hegemony

Other theories of CG include Class Hegemony and Managerial Hegemony. Class Hegemony theory makes directors accountable for their actions, whilst Managerial Hegemony theory allows the management to run the firm's day to day business (Hough et al., 2005). Both these classes inherently possess systems of asymmetric information, as shareholders, and by extension the BOD, are deprived of information due to there not being similar levels of access to the information. Managerial hegemony posits managers becoming well-informed in terms of operations, and therefore disadvantages the board. They therefore become highly specialised in financing and attain the ability to calculate high investment via retained earnings. This means that, to a certain extent, managers will have power over the board. The Board is thus unable to strongly represent shareholder interests.

Overall, CG structures may be explained by the theories above. Based on the cause and effects of variables in the theories (rather than based on one single theory), a combination of these theories could be used to develop an effective CG structure.

For instance, agency theory will resolve agency problems arising from conflicts of interest. However some mechanisms do not work to solve agency problems due to rising agency costs. Thus, when resorting to stewardship theory, the agency problem does not apply because the agents act as stewards not bothered by compensation, *i.e.* they act towards the firm's benefits. Alternatively, looking at stakeholder theory will make firms more harmonious as stakeholder interests are taken care of. Whilst addressing issues of CG, a combination of theories could be more practical to allow CG to be implemented according to the model that best suits the firm.

2.3.6. Disclosures of Corporate Governance

Beyond the prevailing theories on corporate governance, there are also strong fundamental principles that are related to corporate governance. These principles, being human-related behaviour, relate to disclosure, and to a certain extent, corporate governance itself is perceived through how it is reflected in terms of its disclosure.

Mandatory disclosures are statutory disclosure while voluntary disclosures are information which is in excess of disclosure requirements (Damagum and Chima,

2013). Voluntary disclosures are "disclosures in excess of requirements, representing free choices on the part of company managements to provide accounting and other information deemed relevant to the decision needs of users of their annual reports" (Meek *et al*., 1995:555). It should be noted that the need for voluntary disclosures emanates from the fact that financial reports must be capable of meeting the needs of the various categories of users and also serve as a basis for investment decisions by investors and other stakeholders (Damagum and Chima, 2013:166).

There have been many instances that reveal disclosure as being quite problematic and this is not easy to overcome although much is said about lobbying transparency. As mentioned by Forker (1992), the quality of disclosure is a concern and is debated in the UK. As such, before moving on to CG models in the next section, some pioneer works on disclosure are worth discussing, as this study is partly undertaken using a disclosure approach and content analysis.

Based on the reviewed literature, most of the undertaken work on disclosure uses disclosure approach and content analysis as their research methodology. The earlier work mostly focused on corporations with respect to disclosure on corporate governance. A study by Wallace (1988), for instance, looks at disclosure in terms of their mandatory requirements. Using the disclosure approach, his case study looks at disclosure on corporate-listed companies in the People's Republic of China (PRC) and Hong Kong in which he mentions that the difference in terms of disclosure is affected by culture. His study is based on the characteristics of Hong Kong–listed companies, which, he mentions, provide mandatory information in a comprehensive manner in their annual reports. Based on the disclosure index that he developed using the scoring of annual reports disclosure, he sees culture as an important factor that triggers the difference between the disclosure levels between the two countries. Wallace's (1988) study provides a basis that firm-specific factors help explain the variation in disclosure, besides stressing the role played by the environment of financial reporting which speculates on corporate reporting. He mentioned that either the comprehensiveness of the reporting or the mandatory disclosure affects investors in terms of governance, rather than business dealings, and explains how the social aspect of the unification that has impacted corporate reporting affects investors.

Similarly, using disclosure index which was developed in his research on public-listed companies, Owusu-Ansah (1998) investigates the adequacy of disclosure practices on mandatory information by the companies on the African stock exchange. He assesses the "stringency" of the mandatory disclosure of the regulated companies by the regulatory regime of that market and examines the relationship between mandatory disclosure and corporate governance attributes such as ownership structure, audit quality and company age, among others.

In shifting the focus on corporate accounting, Haniffa and Cooke's (2002) study indicates that the interaction of environmental factors influences disclosure practices with regards to corporate governance. Quite similar to the above mentioned work, using the disclosure approach, Haniffa and Cooke (2002) developed a disclosure index to examine companies' annual reports in order to study the linkages between corporate governance variables. They reveal that some firm-specific factors could affect disclosure. Besides firm-specific factors, they also review the importance of CG and cultural characteristics as they highlight that disclosure in annual reports (of Malaysian listed corporations) could possibly determine the disclosure of the corporations.

A recent study by Darmadi (2011) reveals disclosure on corporate governance in annual reports of Islamic banks. He reveals that board member and risk management are strong while internal controls and board committees are weak. As this study focuses on Islamic banking, the disclosure approach used is confined to financial institutions or Islamic banks specifically.

2.4. MODELS IN CORPORATE GOVERNANCE

CG is determined by modes of corporate financing (Okabe, 2004). As such, CG models can be defined by two types of financial systems: market-based and bank-based systems (Okabe, 2004). As this study focuses on financial institutions, it is felt that the models of CG could also be defined by its modes of financing[4]. As such, the next section will present the CG models based on the market-based and bank-based models.

[4] CG models are classified as market-based and bank-based systems (La Porta et al., 2000).

2.4.1. Market Based Corporate Governance Model

"The Anglo-Saxon model of corporate governance, granting total supremacy to shareholder interests, still dominates most free market economies" (Pearson, 2010: 1). It is based upon a fiduciary relationship between shareholders and managers (Clarke and Chanlat, 2009), and draws inspiration primarily from market capitalism, *i.e.* it is derived from the notion of self-interested, decentralised markets regulating themselves (Clarke and Chanlat, 2009). Furthermore, it is defined by individual share ownership with behaviour that is primarily profit-oriented. The firm's owners are aided by the firm's directors based primarily on this notion of a fiduciary relationship between the shareholders and managers. Investors are responsible for supplying capital and having ownership rights over the corporation, but it is the management that is legally responsible for the corporation's actions.

This model utilises a unitary board that has independent and external directors and board members which are focused primarily on enhancing shareholder value (Tricker, 2010). This model is generally compatible with agency theory, which itself was born within a free market economy environment, and sees prevalent practice within the US and the UK. This model possesses a framework which readily defines the rights and responsibilities of management, the Board, and its shareholders. As a one-tier model, the board structure consists of management carried out by one board and reporting to a large supervisory board.

As the Anglo Saxon model relies heavily upon regulation, it has a well-defined relationship between the management and the shareholders (Bryceson, 2006). Furthermore, the model is stricter on disclosure in the US as opposed to the UK and other countries. The US uses a more intricate and heavily moderated system which aids in communication between shareholders, directors, and management.

Apart from the Anglo Saxon model, the next most common model is the bank-based model. In this section, the bank-based model is represented by Germany and Japan. While the Anglo-Saxon model is aligned with agency theory, the German model is potentially considered as being represented in the form of co-determination and Japan's model is slightly similar to stakeholder theory.

2.4.2. Bank-Based Model

As mentioned, there are mainly two models of CG based on bank-based model, which are explored below.

2.4.2.1. German model of corporate governance

Germany's CG model may be better than CG models in the UK and the US. It is especially notable due to Germany's position as Europe's largest economy (Wójcik, 2002). Based on its financial system and mode of CG, the model itself demonstrated high stability throughout the post war period until the mid-1990s (Clarke, 2009). This may be attributed to Germany placing more of a focus on long-term relationships between corporations, banks and investors as opposed to profit.

The German model has a board which is two-tiered. It is comprised of a management board (*Vorstand*), that runs the firm, and a supervisory board (*Aufsichtsrat*) with outside directors only (Sadowski *et al.,* 2005). The management board and supervisory boards are separated by law, thus a clear separation of duties and functions exists. The German model is sometimes referred to as "an insider, networked, bank-based, or closed system" (Wójcik, 2002:5). This model applies legal rights which are more applicable to direct and active control on appointment and dismissal. The supervisory board has important rights and its members are comprised of numerous external individuals. The model is normally identified by its use of prominent shareholders, cross-holdings, and bank supervision. It promotes the usage of universal banks (Hausbanken) wherein banks have large stakes in companies with significant representatives in the boards. Höpner and Jackson (2001:2) opine that, with "The emergence of a market for corporate control", Germany cannot be described as having "a bank-oriented, insider, or stakeholder model of corporate governance". The German model observes a system of *codetermination*. The German system is thus not legally obligated to only pursue shareholder interests as firms prioritise a broader group of stakeholders (Allen and Zhao, 2007) rather than just a few shareholders. The model is explicit in focusing on efficiency and maximising stakeholder value (Goergen *et al.,* 2005) while also avoiding information costs and allowing for greater managerial control. This differs from the Anglo-American system which is aimed at generating fair returns for investors.

According to the model, shareholders and employees are responsible for the nomination of board members (Tricker, 1994). As rights and responsibilities are shared via the usage of dual-tier boards, employees are allowed voting rights on certain issues. While the model suggests that the executive board may have transactions which will need the supervisory board's approval, the composition of the supervisory board is also variable and changes according to the size and type of the company, though its own size is legally set and this cannot be altered by shareholders (Tricker, 1994).

According to the Goergen *et al*. (2005:2) the "German regime is characterised by the existence of a market for partial corporate control, large shareholders, cross-holdings and bank/creditor monitoring, a two-tier (management and supervisory) board with co-determination between shareholders and employees on the supervisory board, a non-negligible sensitivity of managerial compensation to performance, competitive product markets, and corporate governance regulations largely based on EU directives but with deep roots in the German legal doctrine". The supervisory board is also responsible for choosing those in the management board.

The model is also known for being egalitarian in what is often referred to as Rhineland Capitalism (Schmidt and Wahrenburg, 2003), in which decisions are made collectively (Clarke, 2009). This is linked to the model recognising long term goals and stability as significant (Clarke, 2009). Thus, firms are not necessarily obliged to generate high returns to shareholders (Lane, 2003).

In contrast, "In Anglo-American systems there are no supervisory boards, the power of employees is limited, institutional portfolio investors are powerful, capital markets are strong and take-over activities are common" (Wójcik, 2002:5). Keasey *et al*. (2005), however, doubts that banks play an active monitoring role in most firms, but also notes that this is more likely the case in failing companies. Wójcik (2002) however, claims that banks are more significant in Germany as they possess more influence in companies with representatives in the boards.

In the model, banks may also utilise proxy voting (Edwards and Fischer, 1994) to control other companies (Franks and Mayer, 2001). "Proxy voting rights also give the

banks' voice a disproportional vote on the general meetings" (Keasey *et al.*, 2005:15). Thus, the system itself seems to be opposed to outsider control.

Retained earnings are one of the biggest sources of income for German corporations and thus this allows banks to be highly autonomous. Such long-term lending relationships also allow German banks more power, which is further supported by the bank also having a significant voice in the firm's supervisory board (Keasey *et al*, 2005). Thus, the scope and significance of bank control in the German model limit the role of portfolio investors and allow more power to be retained with the banks (Blommenstein and Funke, 1998).

In Germany, the massive amount of control afforded to banks via cross-holdings and proxy voting makes the stock market only play a marginal role in controlling German firms (Wójcik, 2002). As far as employee stakeholders are concerned, the system allows them a certain degree of influence with regards to the operations of the firm in matters which may affect them while also entitling them to a share of the surplus.

On matters of ownership, hostile ownership is almost unheard of in German companies. In fact, ownership concentration is high (Wójcik, 2002) with family ownership still being found in large firms. However, despite banks having significant control over the supervisory boards, their ownership in stakes is not high. Thus, it can be said that, with the control of firms by financial institutions in Germany, problems of agency may be mitigated by virtue of the financial institutions acting as external moderators for the large corporations (Allen and Zhao, 2007).

It should be noted that the model does not utilise the securities market very much. Stock markets are insignificant, and therefore play only a small role in governing German companies (Lane, 2003). In fact, "The number of listed companies and their market capitalization are small in relation to the size of the economy" (Wójcik, 2002:4).

2.4.2.2. Japanese corporate governance model

The Japanese model is in some ways similar to certain aspects of the stakeholder model of CG, which has traditionally been linked to broader views related to the efficient resource allocation of stakeholders and shareholders (Allen and Zhao, 2007).

The model is identified through heavy cross-shareholding[5] among participant banks and clients, companies, or conglomerates (Monks and Minow, 1995). Thus, "ownership within Japanese keiretsu groups is more diffused through horizontal cross-shareholding" (Jackson, 2002) and investors remain unaffiliated with corporations as financial institutions play the more important roles in financing the enterprise and moderating the operations.

The model places heavy reliance on debt-financing, characterised as a main-bank[6] system due to the borrowing (Okabe, 2004). High bank debt large shareholders are a characteristic of Japanese corporations (Yafeh, 1995). According to the conceptualisation of the model, since banks are the main financiers of the company, they effectively play a part in governing companies through cross-holdings and lendings. However, they lack significant roles in boards (Okabe, 2004). In the model, stakeholders are more committed towards the firms' long-term survival, as opposed to the shareholder-oriented U.S. model which focuses on maximising shareholder-value.

The ownership stakes of Japanese firms "are held among shareholders having strong commitment to specific firm and focusing on their strategic interests" (Jackson, 2002). The strength of Japanese-style management, thus, is of long employee retention and links with main banks. It is a model which promotes unity and encourages staff promotion based on performance and loyalty (Tricker, 1994).

In this model, ownership stability reduces the market for corporate control (Clarke, 2009) as the model relies on inside executive directors and a hierarchical structure. The structure, size of the board and the governance processes are dissimilar to the West, and firm structure influences resource usage (Aoki, 1990). Furthermore, the companies are incredibly competent through the use of fair compensation and long-term employment.

Theoretically, shareholders have more rights than those the US and the UK (Allen and Zhao, 2007). This is shown by the fact that shareholders can directly nominate

[5] Cross-shareholding is when new shares are not sold into the market. They are held by the banks or other allied companies (Okabe, 2004).

[6]The main-bank system is a relationship between a firm and a bank when: there is continuous large bank borrowing for a long period; bank is the main shareholders of the firm; bank performs other transactions with the firm; maintain close human relationship and offer rescue in the event of financial distress (Okabe, 2004).

directors and have a say on the remuneration of management during shareholder meetings. In addition, managers are not directly responsible to shareholders (in terms of the fiduciary relationship) and decision making is done collectively, involving debate and negotiation which is left to the top management's ratifications. In the model, all directors are non-independent and executive and no committees exist with the sole purpose of monitoring executive management, executive remunerations, or board nominations. Accordingly Grabowiecki (2006:37) states that, "management mediates between stakeholders by pursuing strategies that focus on markets for high-quality products and the utilization of highly-skilled workforces and stable inter-organizational relationships".

Thus, the fact that there is less of a market for corporate control in Japan seems to indicate that problems of agency are rare (Allen and Zhao, 2007). This, according to Allen and Zhao (2007), is due to the moderating influence of financial institutions on corporations.

2.5. SUMMARY ON CONVENTIONAL CORPORATE GOVERNANCE

Being a well-researched field in literature, CG has very diverse definitions, contributed to by many coming from different disciplines. The definitions are comprehensive in nature owing to their development in economic, investment, legal, management, and many other disciplines. The definitions, through their spectrum of defined objectives, direct how CG can be pursued which then relates to issues of CG today.

Corporate governance structure could be explained by several theories discussed in the preceding sections. For example, agency theory is useful in context but is inevitably constrained by the problem of conflicts of interest between principles and agents. As such, it has to manage between efficiency and cost. To take care of the intersection of interests among stakeholders, the stakeholder theory claims that there is not supposed to be any trade-off between stakeholders. Whether this may possibly be achieved depends on the model adopted which best fits the corporations.

Based on the cause and effects of variables in the theories, a combination of these theories could be used to develop an effective corporate governance structure. Whilst addressing issues of corporate governance, the combinations of theories could be

more practical in allowing corporate governance to be implemented according to any models that suits the firm.

Having explored CG through the conventional understanding, the following section proceeds with an overview on CG from the Islamic perspective through the emergence of Islamic principles of economics as explained by Islamic moral and political economy.

2.6. ISLAMIC MORAL/POLITICAL ECONOMY FOUNDATIONS OF ISLAMIC CORPORATE GOVERNANCE

Economic principles are not new to Islam and can be traced back to the revelation of Qur'an, the holy book of Islam, to the Prophet Muhammad (PBUH) (Ayub, 2007). However, as far as literature is concerned, work on Islamic economics in the modern sense began as late as 1940s (Kahf, 2004). Historically, classical Muslim scholars, such as Ibn-Khaldun, IbnTaimiyya, and Imam Ghazali among many others, had written extensively on economics and finance related matters (Ashraf, 2012), evidencing that the 'great gap' in economics postulated by Schumpeter did not exist (Ali and Thompson, 1999), as Muslim scholars with their original work filled that gap. Using such historical heritage, Muslim economists in the 20th century aimed to revive Islamic economics in a constructivist manner as an alternative system of understanding for the economic development of the Muslim world and beyond. In contemporary times, the development in Islamic economics is further initiated by the work of Mawdudi and Sadr, to name a few (Zaman and Asutay, 2009).

As far as Islamic economics is concerned, rising interests in this area are not confined only to specific Muslim countries (like the Middle East, Pakistan, Bangladesh, and Malaysia) but also the West (Kuran, 2004; Iqbal and Molyneux, 2005). The first commercial Islamic bank was established in 1975 (Zaher and Hassan, 2002), which paved the way for the emergence of developments in Islamic finance in the modern sense. From the 1990s until the early part of the 2000s, Islamic banks (IBs) began to grow but at a relatively slower pace. Not until late in the 1990s did IBs begin to show a significant presence.

Being located within Islamic economics, the early discourse of Islamic finance articulates the essentialised principles of Islamic economics including profit-and-loss

sharing while making reference to the social justice dimension (Asutay, 2012). Even though Islamic financial instruments in origin predate modern Islamic civilisation, its re-emergence did not occur until after post-colonial period, triggered by the quest for the meaning of 'Islamic economic development' that brings about IME (Asutay, 2012). Thus, as an important part and main institution of Islamic economics, the emergence of Islamic banking and finance (IBF) as institutions had to wait for the last quarter of the 20th century when developments in legal frameworks and regulations began to take place (Asutay, 2012).

Islamic moral economy, and therefore IBs, emerged out of a need for fairness and freedom, due to the fact that Islam itself promoted social equality and economic fairness (Chapra, 1985). This resulted in the inception of IBs, objectives may be served which aimed to perform interest-free activities based upon the *Shari'ah*, *halal* transactions, and risk-sharing among investors, banks and borrowers. Siddiqi (1989), for instance, regards Islamic economics as emphasising social justice. As an alternative to socialism and capitalism, Islamic economics is defined by the *maqasid as-shari'ah* and benefits from *fiqh* structures in determining the nature of how Islamic economics is seen as opposed to the actual financialised nature of Islamic finance.

In his attempt to bring about the realisation of Islamic economics, Chapra (1992:4) stresses that the crucial test for an economic system lies not in the professed goals but in the realisation of the goals itself, in which he highlights the significance of world view to address the issues of the economic system. He sees the worldview as providing the function to support the foundation and strategy of the economic system before its goal can be attained, and he sees the economic questions as value laden.

Choudhury and Malik (1992) state that Islamic economics should play a part in building up the economic structure from Islamic sources of thought rather than being merely a discipline which studies the problems of the system as it was originally aimed as a discipline by which the foundation of ethical economics would be derived from the ideological viewpoint of the world as operating according to the will of God and his laws.

Islamic economics relies on a worldview which needs to be filtered before being able to be effective (Chapra, 1992). Similarly, Nomani and Rahnema (1994:41) view

Islamic economic realities as socially constructed and thus on no account is any human endeavour value-free. Each action is produced and acted in a socially constructed manner which then justifies the difference in life's undertakings (Asutay, 2007).

2.6.1. Definition

Islamic moral economy is defined by the conceptual foundations of Islamic economics through the axiomatic approach. Islamic moral or political economy is an Islamic economy with a systemic political economy in nature in which epistemology, institutions, and functions are all interlinked through revealed knowledge.

Formed by the philosophical foundations that themselves were built through the conceptual axiomatic foundation, Islamic economics or moral economy is a distinct discipline of economics with morals derived from the Islamic rationale embedded into it (Asutay, 2007). It is not a complete theory, a simple application (Wilson, 2008), nor a substitute for mainstream economic theory but rather a way of approaching economics moralistically and rejecting the extremes of both capitalistic markets and command economies, and its utilitarian approach focuses on the maximisation of individual material satisfaction.

Choudhury and Malik (1992) regard the Islamic political economy as a discipline which endeavours to study the relationships between policy, economics and politics while also aiming to integrate these with ethical and philosophical concerns. By integrating the epistemology of Islamic political economy into the wider Islamic economic structure and studying the theoretical structure of such endeavours, Choudhury (1999) views the Islamic political economy as a form of humanistic political economy which values humans as equals in all moral and ethical values. Meanwhile, Naqvi (1981) views Islamic economics as a system in which religious, economic, and social dimensions are all integrated to form an overall Islamic system. Still within the context of an order, Asutay (2007) sees Islamic economics as the economic and financial activities outlined by Islamic principles and undertaken by institutions. He views it is as part of the religion dealing with production that is based specific ideology with its own underpinnings.

Broadly speaking, Asutay (2007) views Islamic economics as an ecological order, articulating the concept as a combination of working components that work within the Islamic ethical foundation. Whilst Islamic economics recognises the failures of the current system in promoting welfare, it may also be described as the summation of all Islam's ethical propositions and encourages considering the welfare of others and may also help in regards to the voluntary movement of wealth from rich to poor for welfare purposes (Asutay, 2007).

The Islamic political economy is sourced from Islamic sources of knowledge like the Al-Quran and Sunnah and its operationalisation has been derived from the premises of law and the realities of the market (Choudhury and Hoque, 2004). Choudhury and Hoque (2004) stresses that with this base structure, essential elements relating to cooperation and economic stability are unlikely to manifest without there also being an ethical policy to support it. It is thus the axiomatic nature of this order which makes formation of the Islamic political economy in operationalising the Shari'ah in the Islamic economy possible.

Naqvi (1981) tries to analyse Islamic economics by combining the religious and social aspects with the economic dimension. This is in an attempt to develop a distinctive framework capable of solving economic problems uniquely. He believes that ethical guidelines as the dominant force in economics will allow its rules to be derived from Islamic principles and thus help establish clear economic guidelines for policy-making. In referring to the ethical foundations, Naqvi (2003) highlights how important religious morality is in achieving moralistic values due to how Islamic economics focuses on the behaviour of the individual human.

By the same token, Kahf (1989:43) is of the opinion that the ethical base provides the value system which governs all forms of Islamic economic activities. Ethics represents the integral part of the Shari'ah which helps provide the foundations for Islamic economic theory formulation (Choudhury and Malik, 1992). Through the ethical value, Islamic order provides the economic system in which the process is managed by a set of axioms and principles to achieve the economic objectives (Asutay, 2007:4). In summation, Islamic moral and political economy is an Islamic economy with a systemic political economy in its nature in which epistemology, institutions, and behaviours are all interlinked through revealed knowledge.

2.6.2. The Structure of IME/IPE: The Axiomatic Framework

IME is theoretically developed through strong foundational axioms based upon the al-Quran and Sunnah to create a world order with an authentic value system in the economy (Asutay, 2007:167). In a socially constructed manner, IME aims to develop socially concerned and altruistically motivated individuals which can be defined as 'homoislamicus' as opposed to utility maximising individual 'homoeconomicus' modelled by neo-classical formulation (Ariff, 1989; Asutay, 2012)

In regards to IME's axioms, Choudhury (1986) sees Islamic economics as being devised by humans but itself deriving primarily from independent sources, thus allowing it to be considered an alternative economic system. Choudhury (1992) regards Islamic economics as comprised of a few key principles: *Tawhid* and solidarity, felicity, distributive equity, as well as work and productivity which themselves are connected to IPE principles. It is a derivation of Islamic principles which allow the basis for an alternative economy based upon human welfare (Asutay, 2007).

Islamic economics is made up elements of *addin*[7] (Dali et al., 2013), commitment, and the right of the poor to the wealth of the rich. Naqvi (1981) stresses that secular and religious ethics should not contradict each other. Furthermore, Islamic economics acts as a mechanism which accentuates the naturalistic human desire to perform good deeds (Ahmad, 1976).

Tawhid, as Islam's foundation, carries tenets of the Islamic faith, which governs all fundamental domains of human faith and actions (Choudhury, 1993) and it is not merely an abstract religious doctrine or metaphysical concept as it enumerates a comprehensive ideology and philosophy of life (Khan, 2012:9). Khan (2012:9) looks at *Tawhid* from three different levels: individual, socio-cultural, and politico-economic. According to him, the individual level is a revolutionary concept requiring the liberation of man from all desires and temptations, thus fully submitting oneself to God.

[7] Islam is a religion or a way of life that governs human kinds (Dali et al., 2013)

On the socio-cultural level, he sees *Tawhid* as freeing man from the superimpositions of other men (Khan, 2012:9). Similarly, on the politico-economic level, Khan (2012:9) views *Tawhid* as seeking to liberate man from the political oppression and economic injustice of other men. Choudhury (1993:6) views the *Quranic* concept of *Tawhid* from three perspectives: as psychological, moral, and social phenomena, which assume the principle of integration. Meanwhile Asutay (2007) regards *Tawhid* as a vertical horizon to equality, in which everyone is equally close to God and where everyone is part of the whole system that allows economic activities to take place.

The second axiom, *ad'l*, ensures that everyone receives what they deserve. It refers specifically to equilibrium. Mawdudi (2011), however, does not see it as referring to equality. Different to *Tawhid*, he says that everyone is only equal with regards to their claim to resources. However, in order for this to work, *al ad'l* (justice) must be supported by *al-ihsan* (Naqvi, 1981). This, together with *Tawhid*, helps create balance in the system by fulfilling the needs of people and society. This translates to a quality of life via the equitable distribution of wealth used for growth through making of suitable policies.

The third axiom, *fard* (mandatory action) means that everyone has obligations they must fulfil. This means that performing social good is meant to be a compulsory part of the religion rather than a voluntary action (Asutay, 2007). Thus, Islam fixes western concepts of individualism and capitalism by establishing concepts of *fard 'ala al-ain* (individual responsibility) and *fard 'ala al-kifayah* (collective responsibility) (Naqvi, 1981).

Ikhtiyar, another foundational axiom, is about the free-will of humans. This freedom is entirely unrestricted and up to the human's discretion (Naqvi, 1994). It constitutes functional norms of economic activity in Islamic economic systems by actualising justice through its given individual freedoms (Asutay, 2007:7).

Rububiyyah, another axiom of Islamic micro-foundations, refers to the development path of all things in either a personal, social, or natural context (Arif, 1985), thus implying the integration of economic and social components. As an axiom, it suggests a divine arrangement for nourishment, sustenance, and directions to perfection (Ahmad, 1979:12), implying that everything has a 'development' path through which

to grow. Thus, human beings, the biological environment, and the social environment all have to develop through identified paths for sustenance and perfection (Asutay, 2007:8).

Tazkiyah, an important moral axiom, is implicative of purified growth in trying to attain *falah* (fortune in the world and the hereafter). It deals with growing towards perfection through the purification of attitudes and relationships (Ahmad, 1994). *Tazkiyah* operationalises the fundamental axioms and principles of the Islamic economic system. It is a result of the integration of *Tawhid*, *ad'l*, *fard*, and *rububiyyah* in order to make humans move towards self-development and hence social and economic development (Asutay, 2007).

Khilafah refers to how humans are accountable before God as human freedom and accountability are parts of *khilafah* (Naqvi, 1981). The role of humans as vicegerents on earth is considered the only reason for their worldly existence. Ahmad (1979) asserts that this axiom leads to such unique concepts as individual trusteeship alongside various rules of social organisation. This implies that the *khilafah* axiom includes notions of universal solidarity, sustainable consumption in pursuing a humble lifestyle, and freedom to lead a life (Asutay, 2007:8). Asutay (2007) further explains that *khilafah* also relates to social accountability in terms of being aware of the consequences of the hereafter in all human actions.

As a methodological paradigm, *maqasid-al-shari'ah*, a process-oriented concept meaning 'the objective of *Shari'ah*' with 'the objective' defined as human welfare, is achieved when institutions aim to maximise human welfare. It operationalises institutions in which there are Islamic economic systems by providing them with the working mechanism's nature. In other words, *maqasid-al-shari'ah* is associated with *shari'ah* objectives, in the sense that it provides the structure for conducting economic activity. Furthermore, it is also a form of instruction, and helps to draw the line between licit and illicit sources of income as defined by the *Shari'ah*.

As mentioned by Asutay (2010), IME determines the economic value system's structure, its foundational and operational dimensions, and how individual Muslims are to behave normally. Asutay (2010) regards IE as a discipline to interpret and solve economic problems using Islamic sources of knowledge. As mainstream economics

was deemed inadequate in dealing with issues of uncertainty, the Islamic economic paradigm was created as a response to that (Asutay, 2007).

Since IME can be defined as a system as it was developed based upon a system of understanding, which defines the foundational axioms, values and norms, methodology, operational principles and functional institutions. As such, IBFs should operate in such a framework so that IME's aims and objectives may be served better . Thus, IBFs may be regarded as functional institutions if operating within the IME system. Thus, as a form of IME's institutionalisation, IBFs must regulate the economy while being confined by the Islamic framework and the limits this framework entails, all of which are delineated in the CG framework (Asutay, 2010).

2.7. ISLAMIC CORPORATE GOVERNANCE

Being a structure, Islamic corporate governance (ICG) encompasses the methodology with embedded moral values provided by Islamic principles to indirectly bring moral elements into the system. The previous section provides the rationale for Islamic corporate governance by laying down the micro religious/Islamic foundations. In other words, Islamic corporate governance, by definition, is developed from the Islamic norms, principles and values. Such foundational principles, having implications on every aspect life, by definition, hence, define the nature of corporate governance in Islam. Thus, Islamic corporate governance in its fundamental nature is not voluntary but dictated through the Islamic values by definition of Islamic ontology and epistemology, as explored in the following sections.

The need to locate IBF in IME was hastened after a series of financial crises affected many economies. As crises are claimed to result from ethical deficiencies within the financial system and its related institutions (Kayed and Hassan, 2011), the ethical approach suggested by IME may prove useful in solving the problem. As some ethical deficiency-related failures have manifested themselves within corporate governance practices, it is thus important that an appropriate system of CG is created to provide an ethical outcome. Hence, IME's foundational axioms can help to provide a structure for this undertaking.

Islamic economics' foundational axioms are aimed at creating a system of economics which is primarily human-focused (Asutay, 2007). The axioms define foundational

principles and incorporate elements of social justice (Asutay, 2007:5). On this, Naqvi (1994:47) demonstrates that deducing economic statements from ethical axioms is a scientifically correct procedure.

Thus, because CG sees a definition in Islamic law and because of the value and norms implications of Islamic moral economy, a distinct ICG is possible. The operational axioms are all summarised under the Islamic corporate governance structure which will help every entity and itself.

Therefore, a distinct ICG is possible by moving away from such axioms since they all refer to a particular aspect of creating an ICG with a distinct value system. To proceed with, some highlights on conceptual definitions of ICG may be deemed necessary.

2.7.1. Conceptual Definitions

Corporate governance is about regulating the rights and responsibilities of parties through a legal system of enforcement. It is responsible for determining how parties behave and what their duties are and also that these duties are taken care of (Chapra, 2003).

Despite its diverse definitions, Hassan (2010) views that the conceptual definition of CG do not differ much between the mainstream and Islamic. However, a standard definition of Islamic CG has yet to be achieved (Tapanjeh, 2009).

On the other hand, as the above does not differ significantly from conventional CG, Ibrahim (2006) sees the distinctiveness of ICG as being in its structure, which requires validation to ensure all transactions are *Shari'ah* compliant. However, Tapanjeh (2009:556) says that ICG dimensions have a broader horizon and are unable to compartmentalise roles and responsibilities in which all actions and obligations fall under the jurisdiction of the divine law of Islam.

Despite several underlying principles that support ICG, the following section attempts to rationalise CG from the perspective of the IME by referring to the foundational axioms. It is important to revisit the objectives of IME, within which ICG must be located, to understand the underlying principles of ICG, and the deficits which trigger factors underlining IBF issues.

2.7.2. Rationale for Islamic Corporate Governance

According to Asutay (2007), the above axioms are associated with the state of all human activities and are thus combined to produce harmony and justice in all human endeavours. Furthermore, these activities are undertaken by human agents given free will and thus they are also responsible for the consequences those activities may bring (Naqvi, 2003). In advocating the entirety of Islamic economics, Nomani and Rahnema (1994) uphold that all methodologies in Islamic economics are deduced via the *Shari'ah*, thus allowing for an element of clarity to be had as far as ethical values are concerned.

Hence, these axioms, in addition to *tawhid*, *adalah*, and *ihsan*, represent the core foundations of ICG, as corporations should strive to bring about the realisation of these axioms' consequences within the greater *tawhidi* framework, which, in turn, requires that all stakeholders be made to share the objective of achieving human well-being.

In articulating the larger stakeholder nature of ICG, IME also assumes *rububiyyah* and *tazkiyah* as part of its axioms. While the former refers to developmental paths given by the creator to individuals, society, and the environment, the latter refers to the purification of stakeholder relationships and goals.

ICG, being an IME model, refers to an ethical proposition and framework for Islamic banking. Islamic moral economy's distinctive values are aimed at upholding ethical values in all human affairs inclusive of economic and financial matters that have consequences for organisational management, thus implying a distinct governance mechanism by essentialising the Quranic paradigm.

2.7.3. Locating ICG within Moral and Political Economy of Islam

Combining moral economics and the Islamic economic system via IBFs makes it an integral world system (Oshodi, 2010). Oshodi (2010:10) claims that by "allowing a combination of the moral economic core and the Islamic economic system via Islamic banking and finance would make this integral world system to reduce acts of immorality and corruption; influence better state and market coordination…" to consistently reduce poverty level. Thus, it can be said that institutional, political

vision, aim and leadership are some elements which are present in CG. ICG, meanwhile, introduces a distinctly Islamic ideology via the IBF.

In terms of the functionality or articulations of ethics and morality, ICG is similar to the conventional CG as it sees transparency and ethical concerns such as accountability and honesty as part of their key principles. However, with regards to structure or framework, ICG is distinct as it places the Islamic norms and values at the topmost, above the shareholders' level, so that the ideals of human affairs may be achieved (Choudhury and Hoque, 2004).

As such, a thorough and comprehensive framework named Islamic corporate governance is located in IPE to provide the norms for the organisation to achieve the aim of the IME. Whether this is achievable through IBF, it depends on whether IBF are able to establish that legal, economic, social justice and other such dimensions are to be incorporated into its methodological framework. Islamic finance theorists like Choudhury, Naqvi, Siddiqi, and many others mention that the operational axioms of *'Tawhid', 'adl', 'fard', 'rububiyyah', 'tazkiyyah', 'khilafah',* and *'maqasid al-Shari'ah'* are important elements in outlining the operationalising nature of IBF (Islamic Banking and Finance), which includes corporate governance. By upholding the concept of *addin*, these axioms are conceptualised and operationalized into the various dimensions of ICG: board; structure, committees and senior management; regulatory disclosure and transparency; audit; policies and procedures; support and operations as well as risk management dimensions. The proceeding section explains the principles of CG based on axioms as developed by Naqvi (1994), Ghazali (1990) and Ariff (1983) as cited by Asutay (2007). Thereon '*falah*' is achieved as described through the following:

'Tawhid' when operationalised is reflected through the 'board' and 'structure' dimensions in ICG. The vertical power between man and God can be translated into the power vested in the board in performing their mandate. As much as the board is highly empowered, they are liable for their action, as there is a supreme and utmost power beyond them. As for the horizontal power, this is operationalized between all levels in the structure. Mankind, regardless of their levels in the structure, they are all alike in the eyes of God which brings them vertically equal to God. As for their position between them, they should be horizontally equal in teams of rights. Through

'Tawhid', this assures equal rights to resources as Islam asserts that there is the poors' right in the richs' wealth. Furthermore, between the employee and employer, among the employees, stakeholders, shareholders and society at large, there is no issue on oppression by the powerful on the weak as all mankind are at the same horizontal line to the God. By conceptualising this axiom into ICG, the power vested in the board and shareholders is superseded by the divine power, at the utmost layer of the organisational structure that governs everything. As such any decision making triggered regardless of from which level, will be in line with Shariah principles as such, decision made should be at the 'discretion' of God. In this manner, oppression between mankind is liberated as everyone is owned by God thus by no means that man is subjected to oppression of his own mankind.

With *'adl'*, its conceptualisation into ICG reflects in the way the shareholder and the stakeholders are being treated in whatever manner for instance, in terms of profit and loss, charges, payments and penalty, salary and benefits. As Islam acknowledges rights and responsibilities, committees such as the remuneration and nomination as well as the senior management that work through the conceptualisation fare better in terms taking care of the interest of the employees as no one will be deprived. Their actions are transparent, with trustworthiness and honesty instilled in them which create better working environments among the staff and management. The element of equilibrium can be operationalized. When *'adl'* is conceptualised in ICG through comprehensive policies and procedures, this ensures standardisation and uniformity as Islam instils fairness, justice and transparency. This axiom, when conceptualised into ICG through risk management, also instils the elements of justice and fairness as Islam prohibits financial oppression or any kind of injustice and discrimination.

The operationalization of *'fard'* into ICG improves the 'support and operations' dimension in ICG as each person has his own commitment towards God, himself, the bank, society at large etc. By instilling accountability and commitment, moral hazards do not exist. In fact, along this line, with the axiom *'ikhtiyar'* imposed by Islam, Muslims are forbidden from giving up and, should not lament that everything has been decided by God as the element of freewill is also operationalized alongside the *'fard'*.

As for '*rububiyyah'*, it is the element or concept of obligation to show respect to the divine arrangement. From the 'board' and 'structure' dimensions of ICG, this improves the working environment through clear reporting lines as '*rububiyyah'* promotes concern for order and unity. From the perspective of the employee, the conceptualisation of '*rububiyyah',* when operationalised into the support and operations dimension of ICG, creates a peaceful and harmonious working environment. As for the axiom of '*ihsan'*, when it is operationalized, this helps to maintain social and environmental concept for nourishment and hence harmonious relations between different spheres of life. In addition, the axiom of *'shura'* promotes discussions and feedback to ensure effective interactions thus employees and stakeholders are willing to adhere to rules and Muslims have to oblige to undertake their responsibilities and accountabilities through orders assigned to them. In the ICG context, *'shura'* when contextualised in IBs ascertains fair and just decision-making in the Board meeting.

'Khilafah' is conceptualised through the ethical criteria possessed by the 'board', 'committee', and 'senior management'. They earn respect from staff and stakeholders due to their ethicality, honesty, knowledge and fairness to name a few. As much as they are superior in terms of power, this does not entail taking advantage of the weak or allowing moral hazards to pursue one's own interests. This axiom necessitates maintain harmonious relationship among all as their aspect of decision making brings justice to everyone.

As for '*Tazkiyah',* conceptualising this reflects in the banks growth with staff working in harmony. As this axiom sustains development, it uses the element of monitoring to ensure the right ways of doing things. Hence this is operationalized through the 'audit dimension' to ensure a check and balance to ascertain a harmonious environment as there should not be unethical and immoral actions between staff. In addition to the combination of *tawhid, adl, fard* and *rububiyyah,* there should also be transparency and standardization in terms of actions taken as everyone should be treated fairly regardless of their position.

As mentioned, IME is developed through the formulation of Islamic economics in an attempt to develop its axiomatic foundations. These foundational axioms of IME are the articulation and operationalised aspects of *maqasid al-Shari'ah* which represent

the ultimate aim within the *tawhidi* framework. This debate, hence, has consequences for ICG (Asutay, 2012).

IME is socially constructed with emphasis given on the consequentialist nature of economic development and its substance. Thus, the anticipated result is social welfare or social good with the embedded concept of *adalah*, justice, and *haqq* as the core objectives.

As evidenced, a thorough and comprehensive framework named Islamic corporate governance is located in the IPE to function through the IBF as Islam provides the norms for the organisation to achieve the aims of the IME. The IBF thus needs to establish that legal, economic, social justice and other such dimensions are to be incorporated into its methodological framework.

2.7.4. Social Failure of IBF and ICG

IBFs are supposed to offer ethical solutions to economic and financial dilemmas, something which is unique to ICG and should be capitalised upon by Islamic financial institutions (Asutay, 2012). As mentioned by Tapanjeh (2009:561), corporate governance in Islamic law provides and embodies much larger and vaster guidelines with encompassing duties and practices on how to deal with economic transactions with the moral conduct of a Muslim without even defining the modern world corporate governance as such Islamic laws impetus corporate governance in every individual actions of Muslim up to the social environment.

When IBs began to pick-up in the late 1990s, they were unable to function properly as they were developed without operational and methodological axioms, as research on IME was still under-developed. Consequently, IBs resorted to adopting the neoclassical economic approach, resulting in convergence with mainstream banking. Based on recent developments, IBs are claimed to be neglecting the spiritual and ethical dimensions (Atzori and Mattei, 2009) by converging with mainstream economics, thus not fulfilling the institutional and policy requirements of IE (Asutay, 2012). Whilst analysing the paradigm shift from IMEs to IBs, Asutay (2012) observed divergence between IME's aspirations and the IB's realities. The divergence demonstrates ethical and social expectations that validate the claim of failure. Asutay

(2007, 2012) has deliberated on this by reverting to the source of the IBs' failure for a remedy to fix the shortcomings.

Despite claims that IBs would be highly insulated from the financial crisis, the credibility of such statements was shaken since its position as an alternative banking system was found to be questionable following its failure to uphold the foundational aspects of Islamic economics (Asutay, 2007). As a matter of fact, Asutay (2007) sees IBs often become too occupied with profit maximisation and lose sight of their goals. However, since its adoption in the 1970s, IBs have yet to fully be in line with the foundational aspirations of IME.

Islamic economics is deprived of its aspirations to create a world order, as IBs diverge from their initial aim to support moral economics. As mentioned by Asutay (2012), IME (Islamic Moral Economy), which prioritises social good, is not simply about prohibiting certain activities like *riba* and *gharar*, but it is also about harmonising the various aspects of the economy. Thus, this manifests in IBF, an institutional tool for IME which is aimed at helping human economic development.

CG is considered as one of the areas that the social failure of IBF is observed; as despite the fact that it is expected that IBF's essentialise and operationalise around ICG values and notion, the observations indicate that they are rather share-holder oriented entities in their CG structure (Hassan, 2011), which implies that they only endogenise the interest of their shareholders with some charitable activities. However, ICG, which is an IME-based model, is commended for its endogenising efforts of larger stake-holders in CG as compared to the Anglo-Saxon share-holders and stake-holder models. In fact, Hassan (2009) claims that the unique model of ICG actually fares much better than either Anglo-Saxon systems or the German and Japanese systems. However, the experience shows that Anglo-Saxon practice of CG is prevailing. With IME, IBs should focus on the interests of stakeholders instead, through the ICG framework, which places emphasis on ethical and moral value (Hassan, 2009). Considering that one of the main reasons of the recent global financial crisis is CG failures, the importance of ICG is essential for IBFs to embed in their structures and operation.

2.7.5. Theoretical Perspectives on Islamic Corporate Governance

After rationalising and providing the distinctive nature of ICG, this section focuses on theoretical perspectives developed to explain ICG.

2.7.5.1. Stakeholders theory

Most of the Islamic scholars and analysts encountered so far agree with stakeholders theory due to the nature of its accountability towards the interests of a wider scope of constituents, *i.e.* that of stakeholders and shareholders and not just shareholders. To a certain extent, as far as stakeholders theory is concerned, its accountability with regards to the stakeholders' roles and the protection of their rights can be extended in the context of ICG, as it looks at property rights and responsibilities not limited to human beings alone but encompassing all aspects of life.

Chapra (2003) acknowledges that stakeholder theory may be able to work with the Islamic framework with regards to the emphasis on the equality of stakeholders (even if they do not own equity). In relation to the principle of property rights, his view is in line with the model proposed by Iqbal where he opines that the CG model in the Islamic economic system helps protect stakeholders also rather than just shareholders.

Chapra (2003), however, doubts that an ICG model would be effective without Islamic elements within it, even if stakeholder theory covers much more area than shareholder theory.

Stakeholders theory supports property rights and ensures contractual obligations are honoured as prescribed by Islam. Iqbal and Mirakhor (2004) agree that stakeholders theory aligns with ICG since they see the two as converging on the notion of protecting property rights. Firms in Islamic economic systems are seen as the hub of contracts, which are aimed at maximising returns and minimising transaction costs while also not performing any unethical activity to do so (Iqbal and Molyneux, 2005). In pursuit of this, firms are therefore required to adhere to implicit and explicit contracts without also imposing on the social order. Apart from property rights, stakeholder theory from the Islamic perspective also involves responsibilities. On this, Iqbal and Mirakhor (2004) are of the view that stakeholders theory is not just a matter of taking care of the stakeholders' rights but also on sustaining their rights.

On the same note, Obaidullah (2004) agrees that stakeholders theory could see use I Islamic ethics since it also takes care of non-shareholders' interests. This however, demands CG to take care of the legislation and regulation in relation to issues of CG. On a slightly different note, Obaidullah (2004) highlights how ownership works in Islam as it is comprised of two tiers: as belonging to God (first tier) and as belonging to man (second tier). Thus, Obaidullah (2004) agrees that the stakeholders theory of the firm provides a clear outlining what rights the various stakeholders have in firms in accordance with the Islamic state.

2.7.5.2. Agency Theory

As discussed earlier, agency problems have posed a lot of issues and conflicts in conventional CG. Supporting agency theory is difficult since many past efforts to overcome agency theory issues have led to a divergence from *Shari'ah* principles (Safieddine, 2009). As much as the contribution of stakeholder theory in CG aspect is concerned, the basis of its application in ICG is questionable.

There have not been many reviews on agency theory pertaining to corporate governance from the Islamic viewpoint. Nevertheless, Kahn (1980s) uses agency theory in comparing *mudharabah* and interest-based loans in respect to economic efficiency (Zarka, 2008:12). Interestingly, according to Zarka (2008:12), Khan's work, which shows the benefit of agency theory through the use of control cost on Islamic contracts to compare between different contracts, has triggered several other studies (on the cost control cost) to delve deeper into. Zarka (2008:12) also brings up a point on the importance of information asymmetry between the parties of the contract with respect to the control of cost in agency theory.

In its quest to take into account the interests of the whole stakeholders as opposed to just the profit maximisation objectives, stakeholder theory plays a part in upholding the principles of *Tawhid* through its emphasis on ethics as confined by the *Shari'ah*. Nonetheless, with respect to decision-making, there are still three fundamental questions (by whom, for whom and with what resources) that need to be responded to by firms in an efficient manner (Azid *et al.*, 2007:17). In this regard, Azid *et al*. (2007:17) suggests that stewardship theory could be considered to address some of the

Islamic CG issues as they state that the firm's decision making is made in consideration of the spirit of partnership, taking into account the benefits of the firm.

To date, there has not been much evidence encountered on conceptual ICG with respect to its underlying theories[8]. This could be due to it having to rely on conventional theories to support the framework. In addition to that, as far as literature is concerned, ICG is not as widely discussed compared to conventional CG (Hassan, 2009), specifically in terms of theory. As far as IBs are concerned, its distinctiveness relates to the presence of another layer in its hierarchical structure, i.e. the presence of *Shari'ah* governance.

2.7.6. *Shari'ah* Governance

Since the operation of IBs requires, their operation to comply with *Shari'ah*, *Shari'ah* governance through *Shari'ah* Boards, the nexus of ICG, is often used interchangeably with ICG. For the sake of this paper, the term *Shari'ah* governance refers to functions of the *Shari'ah* board only, which is a key component of ICG.

Shari'ah governance utilises the *Shari'ah* Supervisory Board (SSB), a special board which ensures the operation of the IB is in accordance with the *Shari'ah*. Thus, if an institution desires to offer Islamic products, it must first appoint a *Shari'ah* board (or *Shari'ah* counsellor), and this has become the norm amongst IBs (Solé, 2007). The *Shari'ah* board is meant to be comprised of Islamic scholars who are knowledgeable in economics and it plays a role different to the main board.

As Islamic finance is based on principles established by the *Shari'ah* and other jurisprudences or rulings (known as fatwa, issued by qualified Muslim scholars), it is always faced with complex issues, forcing involved institutions to seek the assistance of experts in interpreting them (Solé, 2007:para. on Shariah compliance). In essence the *Shari'ah* board is aimed at advising IFIs and monitoring transactions while also contributing to the creation of *Shari'ah*-compliant products (Ahmed, 2007).

Rammal (2010:7) lists the functions of SSB as: issuing formal legal opinions pertaining to *Shari'ah*, reviewing and revising transactions and dealings, holding

[8] Except for Choudhury's (2004) philosophical view on Islamic corporate governance.

regular meeting to keep abreast with issues, preparing contracts, preparing studies and research in relation to *zakat* resources, carrying out technical reviews, and following up to ensure that controls are implemented as per *Shari'ah* requirements.

Solé (2007:para. 8 under 'Four Main Principle') highlights that regulator's rulings and decisions are supposed to be consistent with those of the *Shari'ah* boards of foreign supervisory agencies. It is widely agreed that *Shari'ah* matters are always open to interpretation and it is widely mentioned it is difficult to standardise Islamic products due to this fact scholars in the field. Often, IBs are criticized for a lack of uniformity in the way the *Shari'ah* principles are applied and supervised (Rammal, 2010:3). Having said that, IBs, or institutions offering Islamic products, must therefore utilise a Shari'ah Supervisory Board in order to make sure that their products comply with Islamic principles. However, different IBs often share the same scholars as there are not many scholars in the field.

To a certain extent, the standardization of *Shari'ah*-compliant practices has actually increased the acceptance of Islamic products and IBs. Based on Ibrahim *et al.* (2009:233), IBs' rapid growth is attributed to its value-oriented ethos, of which, based on his findings, more than 95% of the respondents felt that "compliance with *Shari'ah* law is a fundamental requirement in terms of 'halal' type of investment and investment structure". This confirms the factor that the compliance attraction plays an important role in increasing the share of *Shari'ah*-compliant property investment, which then contributes highly to the growth of IBs.

To achieve growth and stability, IBs must maintain customer confidence. By implementing good *Shari'ah* governance, it may be possible to mitigate issues of non-compliance with Islamic principles.

2.7.7. Comparing Corporate Governance Models

After discussing the various aspects of CG and ICG, this section presents a comparison table to depict the difference between the CG models applied throughout the countries. The details can be found in Table 2.1, which helps to locate the differences between various models and also helps to essentialise the ICG.

Table 2.1: Comparing the Corporate Governance Models

Aspects	Anglo Saxon Model	German Model[9]	Japanese Model	Shariah Model[10]
Theory orientation	Shareholder	Stakeholder	Stakeholder	Stakeholder
Episteme	Rationalism and rationality	Rationalism and rationality	Rationalism and rationality	'Tawhid'
Country practicing	UK, US, Australia, Canada, New Zealand	German, Austrian and *etc.*[11].	Japan	No-specific country - depending on IB's locality.
Corporate goal	Shareholding control managers to increasing profit	Shareholding control managers to increasing profit	Shareholding control managers to increasing profit.	'Shari'ah' objective
Nature	Management dominated	Controlling shareholder dominated Governed by Supervisory board[12] and Management board[13].	Controlling shareholder dominated.	Concept of vicegerency and 'shura' process.
Structure	One-tier	Two-tier[14]: executive and supervisory responsibility separate	Two-tier board.	No tier-specific-Shari'ah board
Board Composition	"Insiders" and "Outsiders"[15]	Boards' size is smaller than Japan but bigger than US and UK. Supervisory board size is set by law[16]	Insiders[17] Large boards[18] Many-sided *i.e.* main bank and financial network or *keiretsu*[19].	Shari'ah scholars[20]

[9] The German corporate governance model differs significantly from both the Anglo-US and the Japanese model, although some of its elements resemble the Japanese model.
[10] In an ideal situation
[11] Some elements of the model also apply in the Netherlands and Scandinavia. France and Belgium have recently introduced some elements of the German model
[12] The supervisory board appoints and dismisses the management board, approves major management decisions; and advises the management board. It usually meets once a month. Executive and supervisory responsibilities are separate.
[13] Management board is responsible for daily management of the company. The management board is composed solely of "insiders", or executives. Supervisory board contains no insiders", it is composed of labor/employee representatives and shareholder representatives. Management board is responsible for daily management of the company. The management board is composed solely of "insiders", or executives.
[14] Composition of the Management Board ("*Vorstand*") and Supervisory Board ("*Aufsichtsrat*") in the German Model
[15] Board composition and representation is main concern.
[16] And cannot be changed by shareholders Supervisory board includes labour/employee representatives
[17] That is, executive managers, usually the heads of major divisions of the company and its central administrative body
[18] Generally larger than boards in the UK, the US and Germany. The average Japanese board contains 50 members.
[19] The main bank system and the *keiretsu* are two different, yet overlapping and complementary elements of the Japanese model.
[20] Shariah scholars act as the Shari'ah advisor (or some banks have a Shari'ah committee) that monitors and ensures compliance (Nadwi, 2012).

Aspects	Anglo Saxon Model	German Model[9]	Japanese Model	Shariah Model[10]
Regulatory Framework	Well-regulated system for shareholder communication[21]. Larger flow of information to the directors.	Smaller flow of information to the supervisory board. Strong federal tradition[22].	Routine corporate actions requiring shareholder approval[23].	Country –specific.
Disclosure requirements	Very stringent Comprehensive and complex	Stringent[24] Disclosure and mechanisms communication between corporations-shareholders largely resolved.	Stringent	For transparency
Monitoring	By wide range of institutions.	Strong relationship between corporation and main bank.	Strong relationship between corporation and its main bank.	Ethics[25]
Financial Relationships	Non-affiliated shareholders[26] Relationships are prohibited by antitrust legislation	Banks are key shareholders. Banks develop strong relationships with corporations [27]. Relationships are prohibited by antitrust legislation. Investors not affiliated with corporation[28]	Strong relationship with a network of affiliated companies. Interaction and relationships among players. Relationships are prohibited by antitrust legislation.	Strong relationship within the network.
Share Ownership Pattern	Wide range of financing sources[29] Representatives of affiliated shareholders ("insiders") seldom sit on boards.	Relying on a single bank - banks are key shareholders to obtain financing. German banks and corporations hold ownership of the equity	Banks are key shareholders[32] Strong banks-corporations relationships. Preferably affiliated	

[21] In the UK and US, a wide range of laws a well-developed legal framework defining the rights and responsibilities of three key

[22] Both federal and state (*Laender*) law influence corporate governance

[23] Such as: payment of dividends and allocation of reserves; election of directors; and appointment of auditors

[24] But not as stringent as in the US. Corporations are required to disclose a wide range of information in the annual report and/or agenda for the AGM

[25] Sha'riah audit is accountable for compliance. Also corporations should apply **e**thical codes of conduct as instruments of self-regulation (Sacarcelik, 2013).

[26] Have no voice in AGM. As a result, there are few truly independent directors, that is, directors representing outside.

[27] Due to overlapping roles and multiple services provided

[28] known as outside shareholders or "outsiders";

[29] Including the well-developed securities market.

Aspects	Anglo Saxon Model	German Model[9]	Japanese Model	Shariah Model[10]
		market[30] - dominant shareholders Neither banks nor corporations are key institutional investors[31].	parties[33].	
Role of Stock Exchange	Strong role in corporate finance	Reduced		
Market for corporate control	Hostile takeovers are the 'correction mechanism' for management failure	Takeovers restricted.		
Role of banks	Banks play minimal role in corporate ownership	Important both in corporate finance and control		
Ownership structure	Widely dispersed ownership; dividends prioritised. Separation of ownership and control Legal liability for the acts of the corporation is avoided.	Banks and corporations are major shareholders; dividends less prioritised. Co-determination[34] Share ownership of individual, and increasingly institutional.	Dividends less prioritised Co-determination Financial institutions and corporations firmly hold ownership of the equity market[35].	Dividends are less prioritised, as organisations are expected to also maximise *Maqasid as-Sha'riah.* Depending on the jurisdiction of IB's country of origin.

Source: Adopted from Hasan (2011:4), Clarke and Chanlat (2009:146)

2.8. CONCLUSION

As discussed, CG systems in different countries are varied. As much as the differences between the conventional CG models are seen, the models of CG between the conventional and Islamic point of view is even more distinct in many aspects. The main criterion of ICG is that it is based on epistemology sourced from the *Qur'an* and *Sunnah*. Its substance brings the insights of how Islam takes care of every aspect of life not only in economics, politics, and the financial sector but all other aspects of life

[32] and develop strong relationships with corporations, due to overlapping roles and multiple services provided

[30] Similar to the trend in the UK and US, the shift during the postwar period has been away from individual ownership to institutional and corporate ownership

[31] The mandatory inclusion of labour/employee representatives on larger German supervisory boards further distinguishes the German model from both the Anglo-US and Japanese models.

[33] In contrast, outside shareholders represent a small constituency. "Outsiders" seldom sit on Japanese boards.

[34] Regulate the size and determine the composition of the supervisory board; they stipulate the number of members elected by labour/employees and the number elected by shareholders

[35] Shift during the postwar period has been away from individual ownership to institutional and corporate ownership.

too. Its consequence on the financial sector can be operationalised through IBs. Thus, in achieving its aims and objectives, ICG is being steered and navigated by Islamic principles and shaped in accordance with morals and ethics.

In concluding the meaning of IME should be looked at beyond economics. It is generally viewed as an economic system embedded with ethics and moral values. Despites its various definitions, depending on which perspectives it is looked from, IME is a complete humanistic system that blends religion, economics, and social aspects to reach balance from many aspects such as politics, economics, society, and religion. It is to achieve equilibrium in order to form unity by linking all the elements together as an integrated relationship, which deals with observations and interactions in addressing the many aspects of life. Such a paradigm inevitably has consequences for CG as well in shaping the relationship within an organisation. As explored in this chapter, the details of the IME do rationalise such a view in developing a particular notion and mechanism of CG in the form of ICG with distinct values, norms and operational framework.

CHAPTER 3

RISK MANAGEMENT FROM CONVENTIONAL AND ISLAMIC PERSPECTIVES

3.1. INTRODUCTION

This chapter aims to present a survey of the literature in relation to risk management issues from both the conventional and Islamic perspectives. Whilst its aim is to enable comparison to be made on risk management between the conventional and Islamic perspectives, it also provides an overview on the structure that supports risk management in conventional banking before bringing the focus to the underlying principles that support the risk management structure for implementation and execution in performing Islamic banking operations.

The chapter is organised into two main parts: Part 1 and Part 2 deal with the conventional and Islamic perspectives respectively. Part 1 presents some definitions and key risk areas to enlighten upon the conceptual definitions of risk. It then describes the principle dimension of the risk management framework including the sources and forms of risks, strategies, and types of risk. Similarly, Part 2 brings in some definitions of risk that are inherited by Islamic banks. The coverage on the underlying Islamic principles that uphold the risk management practices in IBs will also be discussed.

3.2. RISK MANAGEMENT IN CONVENTIONAL BANKING

The recent financial crisis impinged upon the macro economies of most of the countries in the world through changing the structure of capital allocation, affecting the financial system through banks and non-financial corporations. Banks especially, were subsequently bombarded with claims of a lack of corporate governance and risk management as the trouble unfolded (Kirkpatrick, 2009). Not only that, shortcomings in corporate governance is widely portrayed as the cause for the recent financial crisis and economic slowdown, the latter coming as a wake-up call for risk management as well, putting part of the blame on poor risk management of the financial institutions.

Recently, corporate governance has become distressed, stretched so far and has been unable to cope with the demanding financial environment, thus accentuating the need for risk management. As banks are often seen to play important roles in the financial environment, risk management has become a key issue (Styger and Wyk, 1998), especially when the banks' ability to lend affects the macroeconomic environment (Egan, 2003).

The fact that banks have been facing business risks that may negatively affects them have placed the board and senior management under pressure (Baysinger and Butler, 1985). With the emphasis on types of risk and strategy to manage the risks, the board is expected to increase their knowledge and have additional capabilities for effective risk management so as to have an integrated view of risk control. To start with, a conceptual definition on the subject matter is worth revisiting.

3.2.1. Conceptual Definitions

Risk is implicative of different concepts and measures that lead to words like risk analysis and risk assessment being used in various interchangeable manners (Ansell and Wharton, 1992). Banking businesses face plenty of risks which have the potential to lead to varies effects in either profit or loss (Bessis, 2002However, definitions of risk and risk management can vary between people. For instance, Sobel and Reding (2006) define risk as a function of severity and likelihood that may or may not manifest in a variety of ways.

Risk may be defined as an uncertainty value (Artzner et al., 1999). This can be seen as being comprised of two components: the probability of an activity's consequences and how severe the activity's consequences are (Graham and Rhomberg, 1996). Similarly, according to De Lorenzo (2006), risk is always related to future uncertainty and how decisions can spawn multiple outcomes.

Regardless of how risk is viewed, it can be generalised as the possibility of uncertainties happening, something which is normally undesirable because the impact can be a threat in the achievement of objectives or result in a missed opportunity. Thus risk has to be managed to prevent or at least moderate the adverse impact.

3.2.2. Risk Management

Paradoxically, risk management itself can be seen to have been triggered by the desire to survive (Ansell and Wharton, 1992). It represents the process by which managers identify key risks; obtain consistent and understandable operational risk measures; prioritise risks while also choosing how the likelihood of such risks may be either increased or decreased; and establish procedures to monitor resulting risk (Pyle, 1997).

Risk management may be seen as a process in which a financial institution defines a business strategy and responds to the strategy appropriately. This can be see within the State Bank of Pakistan (2010), which sees risk management as a discipline that forms the basis of the financial institution, encompassing all activities affecting related risks. It involves identifying, measuring, monitoring, and controlling risks. It regards managing financial risk as an integral part of its role as a financial intermediary while also stating that institutions should not take unnecessary risks nor absorb risks that can be transferred to other players. Rather, risks that are inherently a part of the bank should be accepted. Beyond that, Ahmed (2009) defines risk management as a strategy's focus, highlighting the need for support, and the relevant processes and systems, to be in place.

On a slightly different note, Scholes (2000) sees risk management in relation to documentation. Looking at risk management from a higher level (*i.e.* risk management systems) and based on a structural perspective, risk management should be treated separately to risk analysis. This ensures that decisions are objective and based on relevant information. Scholes perceives risk management to be an exposure accounting system[36] and a control system that helps determine the firm's capital requirements. He then broadly categorises risk into two parts. First is risk analysis involving risk identification, risk definition, risk evaluation, and the risk action plan and its impact. Second, he relates risk management to activities such as planning, monitoring, and controlling actions to deal with problems. Scholes (2000), further stresses that recording information is important in risk analysis and risk management as it supports overall risk management.

[36] Scholes (2000) defines an exposure-accounting system as a dynamic system that assesses the effects of changes in economic factors.

The above definitions do not differ much from one another despite literally having slight differences in defining and structuring the process. Generally, the main components of risk management are: risk identification, risk mitigation, risk assessment and risk estimation. These processes, however, come with costs that organisations have to deliberate on.

With regards to issues of risk management in banks, which is always associated with corporate governance, the decision-making part of risk management may only be relevant or play an effective role at certain levels within the institution. Clark and Urwin (2009) in their writing with regards to investments mention about decision making where, quite often, poor corporate governance stems directly from a weak BOD. Putting this into perspective, it can be said that weak corporate governance could also be related to risk management which has not been attended to by the BOD.

Clark and Urwin (2009) lists five types of decision-making process affecting risk management. These are: structural decision making, strategic decision making, tactical decision making, operational decision making, monitoring and oversight decision making. In a relatively simplified version, his types of decision making of risk management are as follow: The 'structural decision making' refers to the institutions' goals usually identified by stakeholders and shareholders. 'Strategic decision making' refers to matching the institutions' goals with its investment strategies. Meanwhile, 'tactical decision making' refers to decision-making based reacting to events, and 'operational decision making' refers to decisions required to maintain banks functions which are ordinarily delegated to the senior executives of the banks. Apart from being a routine, the 'monitoring decision making' refers to the institutions' oversight on how its investment decisions are undertaken.

Based on the above, as far as risk management is concerned, with reference to the nature and scope of the decision-making process taken on by boards, the type of the decision made is important in addressing risk management issues.

3.2.3. Motivation and Rationale for Risk Management

The Global Financial Crisis demonstrated how the failure of financial institutions increases the probability that other similar institutions will also fail (Tao and Hutchinson, 2013). The need for risk management arose following a combination of

the heightened financial crisis and financial product innovation (Greuning and Iqbal, 2008). An increase in bank competition due to bank mergers as well as changes in the banking system that now has direct accesses to the market have also contributed to the need for risk management (Iqbal and Mirakhor, 2007). Aebi *et al.* (2012) mentions that the financial crisis following the US subprime crisis led to a growing need for risk management techniques and structures. They posit that there needs to be a focus improving the measurement and management of specific risks. Furthermore, the issue of how these risks may be summarised is also addressed.

From the firm's point of view, Christofferson (2011) mentions that RM may increase the firm's value by reducing the default probability. He also believes that RM could increase the firm's value by reducing the net present value of the future tax payment. He mentions that proper RM could allow firm to grow through debt financing while perceives that RM could reduce the cost to retain staff as firms become less riskier as according to him, the more risky the firms the higher compensation they have to pay to the staff. Furthermore, Scholes (2000) points out that a risk management system can help determine the firm's need for capital. Banks use capital as a buffer to finance debt so that, in the event of defaults, banks can cushion the loss. This can be achieved if the banks have an adequate and proper match of debt and equity.

From a management perspective, Pyle (1997) sees risk management as a way to identify risks to maximise the value of the organisation's activities and outline the manner in which such risks affect the organisation as it increases the likelihood of achieving the organisation's overall objectives. Companies can then ensure that these risk are responded to and that the response is consistent with their overall strategy and compatible with their risk appetite.

From the conventional economics perspective, Askari *et al.* (2010) examines the significance of risk in conventional banking. He reiterates the work of renowned economists such as Keynes, Fisher, Hicks, and Kaldor (1930s) who agree on the role of risk towards improving capital gains and hedging activities. Askari *et al.* (2010) also sees risk as crucial for generating income. He notes that there is more appreciation of the importance of risk with respect to arbitrage pricing and efficient markets as the vital components for the development of capital markets.

Developments in risk management are also seen to help reduce individual risk and improve economic output and welfare (Shiller; 2003; Askari *et al.*, 2010).

3.2.4. Types of Risks

As much as there have been many definitions on risk, there are also many variations in terms of risk categories. Pyle (1997) categorises risks based on their value of loss. He views major sources of value loss as coming from market risk, credit risk, operational risk, and performance risk.

According to (Santomero (1997), risks in business fall into two categories, namely market and financial risk. He views market risks as a law of nature which can only be known precisely by God, which contrasts with systematic risk as man cannot control market risk. Meanwhile, he terms financial risk unsystematic, the opposite of the market risk.

Risk taxonomy may be seen as artificial as distinguishing lines are unclear (Christofferson, 2011). For the sake of this discussion, this section will briefly go through a general consensus of the description of the five broad types of risks; credit risk, market risk, liquidity risk, operational risk and reputational risk.

Credit risk

Credit risk is the probability that parties will default on financial contractual obligations. It is defined as "changes in portfolio value due to the failure of counter parties to meet their obligations or due to changes in market's perception of their ability to continue to do so" (Pyle, 1997). Crouhy *et al.* (2006, 14) defines credit risk as "the risk of loss following a change in the factors that drive the credit quality of an asset".

Credit risk is also affected by counter party ratings, the size of the banking and trading book, the legal system, collateral quality, maturity of credit facility, and the internal control system (Alam and Shanmugam, 2007). Thus, according to Alam and Shanmugam (2007), credit risk is far more important and difficult to measure and control compared to any other risks.

Market risk

Market risk arises out of possible adverse movements in market prices of commodities, stocks, bonds, currencies, derivatives. Christofferson (2012) defines market risk as the risk to the bank's financial portfolio due to market price movements. On the other hand, Bessis (2002) defines market risk from the perspective of losses in balance sheet positions, also resultant from market price movement. Like most risk experts, Bessis (2002) views risk as subject to interest rate risks and equities in the trading book as well as exchange rate and commodities risk throughout the bank.

Bessis (2002) views market risk in relation to risk measure. He looks at it from two perspectives which are the internal and the external views. According to him, there is a difference between the internal and external views of market risk measure where, from the internal perspective of the bank managers, a measure should allow active efficient management of a bank's risk position. The external view is derived from the regulators, which is to ensure the bank's potential for catastrophic net worth loss is accurately measured and that the bank's capital is adequate to cover losses.

Liquidity risk

Bessis (2002) considers liquidity risk from the aspects of funding, market and assets. Funding liquidity is related to risk based on market perception. As for the market liquidity, it depends on the volume of trade. Its vulnerabilities owe much to its inability to raise money at acceptable costs. As for asset liquidity, it is caused by insufficient liquidity in the market to liquidate the assets. On quite a similar note, Crouhy *et al* (2006) regards liquidity risk as a component of both the funding and the asset of liquidity risk, considering funding liquidity risk is inherently linked to a firm meeting its cash demands. As for the assets, it is triggered by an inability to liquidate assets due to inadequate market demand.

Operational risk

Operating risks are the risk of loss resulting from inadequate or failed internal processes, people, and systems from external events, which includes fraud, damage to physical assets, business disruption, and legal risk. "Operating risks are risks

stemming from failed internal processes, people, and systems from external events" (Basel Committee, 2001). The definition refers to defects which may prove fatal to the institution (Bessis, 2002). Jobst (2007), however, views legal risk to come under operational risks since he views that operational risk stem from a failure to comply with laws, standards, and contractual obligations.

Some contingency plans that help manage operational risks include the creation of a system for registering and reporting undesirable incidents. These would be analysed continuously in order to limit the chances of them happening again or at all.

Reputational risk

Reputational risk is the risk of a bank being perceived negatively from events affecting it (Bessis, 2002). As a risk type, it came to prominence slightly later, *i.e.* after accounting scandals in the late 1990s. Based on a survey released in 2004, 34% of international bank respondents believe that reputational risk is the biggest risk compared to market and credit risks (Crouhy *et al.*, 2006).

Crouhy *et al.* (2006) asserts that reputational risk is particularly relevant in emerging issues such as from scandals in Enron and WorldCom to name a few. On that, the attention of regulators and investors is focused on strategic and business risks instead of quantifying risk in the market and credit risks. As reputational risk is a real threat to financial institutions, they need to gain credibility from their customers, regulators, and creditors at the very least (Crouhy *et al*., 2006). Crouhy *et al.* (2006) reasons that the development of new products places pressure on how accounting and tax rules are interpreted and whether or not certain transactions are legal, thus affecting the financial institutions' reputation. As financial institutions are under increasing pressure to demonstrate their ethical, social, and environment responsibility, there is even more reason for them to clearly monitor and manage their reputation risks.

3.2.5. Risk Classifications

It addition to the above mentioned types of risk, for all the types of risk, they come from different categories. For example, regardless of its types, risks can be distinguished as either inherent or residual risk (Ahmed, 2009). Risks that are present

before any controls or actions take place are known as inherent risks. As for residual risks, they are the ones left after measures are undertaken.

It should be mentioned that risks are categorised into three levels; institutional, organisational and product level (Ahmed, 2009). Ahmed considers institutional level risk to emerge from failures in the legal framework, which makes institutions less flexible and thus less effective in avoiding risks (Ahmed, 2009). Moreover, risk at the institutional level is triggered when procedures are not regulated. Thus regulators need to understand new risks and keep abreast with innovations.

As for risk at the organisational level, it occurs due to absence of legislation. Ahmed (2009) views that this happens when the bank management fails to classify risks appropriately, *i.e*. as risks that can be shifted, avoided, and or accepted by the banks. At the product level, risk is seen as diverse and its idiosyncratic nature is based on the product itself. The probability idiosyncratic losses occurring can be reduced via the diversification of insurance and the bank's internal controls (Ahmed, 2009). These could be managed through detailed procedures for activities in the operational units according to its risk treatments.

With regards to risk treatments, different risk profiles exist for different products and thus each product must have its own treatment (Ahmed, 2009). This is also agreed by Crouhy *et al.* (2006) who suggests that understanding risk types is essential because of the many different categories of risk and their associated risk management skills. In fact, some risks can be eliminated and trusted. However, their complexity and how difficult it is to separate these risks from transactions requires them to be absorbed by the bank.

As a further classification, some risks can also be mitigated or removed by transferring or selling these risks in well-defined markets. Some risks may even be avoided entirely. According to Crouhy *et al.* (2006), risk avoidance includes techniques that comprise standardising business-related activities, creating diversified portfolios, and executing schemes which call for accountability of actions. Furthermore, risk transferring mechanisms include using derivatives for hedging, selling, or buying financial claims.

To help address risk management issues in banks, they are required to prescribe procedures for risk identification, measurement, and assessment. Assessing risks is aimed at fact-finding and associating specific sources of risk with their possible outcomes (Graham and Rhomberg, 1996). In recent years, as per regulatory requirements, banks are obliged to manage their data according to the Basel II[37] requirement.

3.3. RISK AND RISK MANAGEMENT IN ISLAMIC BANKING

Islamic banks have become a significantly important component of domestic intermediaries, as they begin to handle large volumes of assets. Their presence in the global front has become more prevalent, witnessing Islamic banks beginning to offer various financial products. Obviously, the expansion in the Islamic financial market has translated into growth, which later induces concerns among many Islamic finance experts, prompting their inquests into the banks' risk management aspect. With a growing realization among IBs that "sustainable growth requires the development of a comprehensive risk management framework geared to their particular situation and requirements" (Greuning and Iqbal, 2008:4), risk management has become an important part in the operations of Islamic banks (Obaidullah, 2008).

Islamic rules essentialise the important of risk, and therefore, theoretically the strength of Islamic banks is supported by the notion that they are linked to their risk-sharing features (El-Hawary *et al.*, 2006). In addition, Islamic banks are perceived to have inherent risk-managements features that enable the smooth running of the global financial system (Marston and Sundarajan, 2003). However, Greuning and Iqbal (2008:4) states that "interpreting the Islamic financial system simply as free of interest does not capture a true picture of the system as a whole. Undoubtedly, prohibiting the receipt and payment of interest is the nucleus of the system, but it is supported by other principles of Islamic doctrine advocating social justice, risk sharing, the rights and duties of individuals and society, property rights, and the sanctity of contracts".

"From an economic standpoint, by prohibiting interest rate-based contracts and ordaining exchange contracts, the Quran encourages risk sharing and prohibits risk

[37]The Basel II framework helps to attain stronger risk management practices in the banking system as it presents a wide variety of risk rating models.

transfer, risk shedding and risk shifting" (Mirakhor and Krichene, 2010). Similarly, Mohieldin *et al.* (2011:2-3) view that "The core principles of Islam lay great emphasis on social justice, inclusion, and sharing of resources between the haves and the have nots". Mohieldin *et al.* (2011:2-3) add that "Islamic finance addresses the issue of "financial inclusion" or "access to finance" from two directions—one through promoting risk-sharing contracts that provide a viable alternative to conventional debt-based financing, and the other through specific instruments of redistribution of the wealth among the society".

In relation to investment, the vast development in the use of Islamic products in recent years also has partly attributed to the enormous wealth in which investors in Islamic countries need to structure their investments for liquidity purposes in a *Shari'ah* compliant manner. As elaborated by IBI (www.newhorizon-islamicbanking.com: 19-20), "in an Islamic finance system in which there are no risk-free assets, where all financial assets are contingent claims, and in which there are no interest rate-based debt contracts, it has been shown that the rate of return to financial assets was determined by the return to the real sector. Output is divided between labour and capital. Once labour is paid, the profit is then divided between entrepreneurs and equity owners. Since profits are ex post, returns on equities cannot be known ex ante."

IBs, with regards to Islamic product development however, are still lagging in their risk management (Ghoul, 2008: 1). As a consequence, product developers have been tasked with creating innovative channels to attract funds (Yunis, 2006). However, as Islamic products are quite unique, ambiguities in Islamic banking are quick to arise (Sattar, 2011). Thus, despite its special feature, Ali (2007) views that IBs' experiencing financial distress is due to the fact that they are less susceptible to instability. As Marston and Sundarajan (2003) point out, Islamic banks are vulnerable because of their unique risks as they can pose drastic implications for systemic stability.

Nonetheless, the vast development in the use of Islamic products in recent years is partly attributed to the enormous wealth in which investors in Islamic countries need to structure their investments for liquidity purposes in a *Shari'ah* compliant manner. Islam agrees with how important risk is, and is not opposed to Islamic finance following the conventional economics so long as such developments also prohibit the

notion of free-risk, interest-bearing debt (Askari *et al.*, 2009: 49). It is through its risk-sharing basis that the IB system facilitates lending, borrowing and investment functions (Khan and Bhatti, 2008).

Islamic banks are claimed to be less susceptible to instability (Ali, 2007) than conventional ones owing to their risk-sharing feature. However, despite this special feature financial distress among Islamic Banks still exists (Ali, 2007). As Marston and Sundarajan (2003) point out, Islamic banks are vulnerable because of their unique risks as they can pose drastic implications for systemic stability. On another note, Hawary *et al.* (2006) theoretically support the notion that the strength of Islamic banks strengths may be linked to their risk-sharing features. Islamic banks are perceived to have inherent risk-managements features that enable the smooth running of the global financial system (Marston and Sundarajan, 2003).

Despite the risk-sharing feature, Islamic banks can be more vulnerable than the conventional ones since the common hedging instruments of the latter cannot be applied in Islamic banking as they are not *Shari'ah*-compliant. As widely mentioned in the literature, foreign exchange, interest rate, and liquidity risk are all caused by asset-liability mismatches of Islamic banks. These are discussed further at a later part of this section.

Beyond this, Ayub (1997) sees the global financial system as subject to many types of risks. Despite the risk-sharing feature, Islamic banks can be more vulnerable than the conventional ones, since the common hedging instruments of the latter cannot be applied in IBs, as they are not *Shari'ah*-compliant. As widely mentioned in the literature, foreign exchange, interest rate, and liquidity risk are all caused by asset-liability mismatches of Islamic banks. These are discussed further at a later part of this section.

3.3.1. Rationale for Risk Management and Its Underlying Islamic Principles

The main difference between risk management in conventional and Islamic banks is that the latter upholds the principle of risk sharing. It is the concept of profit and loss sharing (PLS) that distinguishes Islamic risk management from its conventional counterpart. As an extension of this principle, risk-sharing nature of Islamic financing has implications for risk management.

Similarly, Dusuki and Dar (2005) believe that risk management represents a system of risk-sharing on stake and equity. It is clearly founded upon idealistic principles of collaboration which encourages mutual cooperation between investors and fund users. By sharing society's burden, risk management encourages "risk-sharing, promotes entrepreneurship, discourages speculative behaviour, and emphasises the sanctity of contracts" (Iqbal, 1997). Thus, through its efficient risk-sharing facilities, risk management promotes and increases the diversification and allocation of resources (Askari *et al*., 2010).

In the vein, Hassan (2006) who states that sharing risk and reward is considered as an integral part of Islamic risk management, associates risk-sharing concepts with the moral economy of Islamic finance, which help build economic justice as essentialised by Islamic principles. Therefore, Hassan (2006) locates Islamic risk management as an integration of the PLS concept and socio-economic justice, further claiming that justice in Islam is an essential part of human society as a society devoid of justice can only head towards decline and destruction. Justice, according to him, is only attainable if there is a set of moral values that humans agree to adhere to. Islamic risk management, thus, helps to support the pillars of Islam whilst supporting Islamic banking while taking ethics into consideration.

Another notable difference is with respect to risk taking behaviour. Islam is not opposed to risk taking; it proscribes two extremes of risk which are risk avoidance and excessive risk-taking. Obaidullah (1998) sees Islamic risk management as a principle which leans towards creating a cornerstone of Islam. It can somewhat tolerate risk taking and uncertainties, but key elements such as *riba*, *gharar*, and *maysir* should clearly and strictly be prohibited (Obaidullah, 1998). Through its criteria of freedom from *gharar*, *riba*, *maysir*, and freedom of trade, to name a few, Islamic risk management upholds the concepts of Islamic finance.

Ayub (2007) believes that assuming risks is necessary before any return on capital, or otherwise profiting over an investment, can be expected. This is also agreed by Kuran (1986), who argues that profit sharing solely through money is impermissible as it is impossible for money to earn a return when it does not act as capital. In this regard, Ayub (2007) does not oppose profit sharing provided the money is used as an investment via real activities, as he believes that transferring commercial risk without

also transferring the reward is impermissible as profits must be earned through risk and reward sharing. He views that Islam promotes taking calculated risks only when gains are expected. However, the encouragement of higher returns may also lead to moral hazards, as risk can also offer opportunities. Thus, Ayub (2007) sees risk-taking as one of the conditions for a party to be entitled to any profit over the principal. On that, despite his approval on Islamic banks taking risk mitigation measures, Ayub (2007) stresses that risk that can only be mitigated but not eliminated.

As for Obaidullah (1998), besides achieving ethics, risk management helps achieve the regulator's objective, namely to increase efficiency. As far as the regulation goal is concerned, a conflict exists between efficiency and ethics (Obaidullah, 1998). Obaidullah (1998) sees that, whilst moving towards ethics, the notion of efficiency is misplaced. He views that, more often, the regulation's goal is to achieve efficiency over ethics. Obaidullah (1998) stresses that there is actually no real cost in terms of loss of efficiency in the market. He views that notions of efficiency are inherent within Islamic financial ethics and usually misplaced emphasis on certain dimensions of efficiency are the ones which cause the most conflict.

Advocating the ethical Islamic banking, Obaidullah (1998) sees Islamic risk management as fulfilling the goal of regulations with regards to efficiency, and therefore, he stresses that Islamic banking needs Islamic risk management for its vital contributions to the financial market as the latter helps in mobilizing funds efficiently through the allocation of funds. Thus, if market efficiency is measured correctly, Islamic banks can help to achieve efficiency. Obaidullah (1998) explains that efficiency can be increased if funds from the saving-surplus unit can be allocated to the right fund-saving deficit unit in the economy. He also views other matters as including pricing efficiency, which can be achieved if transactions can be kept at a minimal cost.

Risk management is a mechanism to reduce inherent risks to a certain level so that residual risks can satisfy the risk appetite of wider constituents of stakeholders (Ahmed, 2009). It is one of Islamic finance's key functions that facilitate households.

From a macro perspective, risk management is in high demand stemming from competitive developments in the Islamic financial market. High demands for Islamic

products are present in both the GCC and non-Muslim countries (Ali, 2007). Increases in market volatility, financial innovation, shifts in banking business models, increases in competition due to mergers and acquisition, and regulatory requirements are among the factors that demonstrate the importance of risk management (Iqbal and Mirakhor, 2007).

Islamic risk management helps to pool and allocate risks (Ahmed, 2009). The concept of PLS based on a fair ratio financiers and FIs may lead to more efficient resource allocation as business risks are equitably distributed and thus help improve the investment climate (Chapra, 2001:313).

Apart from upholding fairness and socio–economic justice in the IB sector, Islamic risk management has an instrumental role in prohibiting the receipt and payment of interest as the core of the risk management system. This can be achieved when it is supported by other principles of Islamic doctrine such as, advocating risk sharing, individuals' rights and duties, property rights, and the sanctity of contracts (Ayub, 2007).

It is also important to note that risk management is part of a process to ensure a sustainable future for the next generation. It does not compromise on human well-being. For example, risk management frees people from the burden of debt and the ones in need will not be deprived. This is evidenced through when those who are in need can then have access to funds which are made possible by banks which give priorities and preserve endowment and resources to them. It is again associated with the concept of PLS as banks become more equitable in wealth and income distribution via a more viable allocation of funds and resources.

Also, instead of feeling discouraged by the prospect of seeing their ideas transformed into business entities (as financiers assess risk involved more cautiously), entrepreneurs and investors will feel more encouraged to engage in more productive economic activities through risk sharing (Ayub, 2007). This, however, depends on the onus of the entrepreneur to reveal to the investors the profit that they make. The allocation of funds is more efficient through profitability rather than looking at customers' credit worthiness.

In the case of the banks and their counter-parties and depositors, they are to participate in the risk-sharing of their banking business. The depositors of investment accounts in the Islamic system are required to share the bank's profits and losses with shareholders, and hence risk losing all or part of their initial investment (Swartz, 2012). The shareholders and investors depositors should absorb any negative shock to Islamic banks' asset returns.

An element of direct market disciplines is also inherent within this principle (El-Hawary, 2003; Iqbal, 2008). Risk management in IBs hinges on transparency. When an element of honesty exists, a disclosure of reliable and timely information to the market participants is possible. Thus lenders can monitor the use of funds by borrowers which will inculcate better lending discipline. It helps to avoid adverse selection and moral hazards by the borrowers. In addition, there will be a fair sharing of financial resources created by the IBs (Langton *et al.*, 2011), which should become available to the poor in moderating inequalities of income and wealth.

From the business perspective, risks management is an integral part of the business of financing as it ultimately ensures a good income flow and business continuity (Obaidullah, 1998), which is predicated differently from the one from conventional banks as it is based on one of the main principles of *Shari'ah* which emphasises justice and equality. *Shari'ah* requires transactions to be just, fair, and ethical in its dealings. In addition, one party may not financially exploit another as the balance of risk (and reward) should be proportionate (Ali, 2007).

From the investment point of view, according to Mirakhor (2009), the risk sharing characteristics of Islamic risk management has better stability than its conventional counterpart as production is financed entirely by risk-return sharing or equity finance. He views that assets and liabilities both move in the same direction simultaneously when price changes thus the financial structure adjusts in tandem on both sides of the ledger. In fact this adjustment process has demonstrated that IBs has the ability to response to shock (Mirakhor, 2009).

3.3.2. Risk Classifications in Islamic Finance

Despite several factors influencing risks, the ones determining risk are human decision and behaviour (Ahmed, 2009). It depends on risk appetite, which reveals the

stakeholder preference (Ahmed, 2009). Risk classification varies depending on the definitions given by its scholars. However, as far as its conceptual definitions are concerned, it all boils down to the same meaning despite their literal differences in definitions.

As mentioned earlier, Islamic banks usually have more risks attributed to them (Hassan, 2009) as compared to conventional banks. . Like conventional banks, Islamic banks face credit risks, market risks, liquidity risk, operational risk, and reputational risks, among others. Obaidullah (2002) broadly classifies the risks of credit and market risks as the main risks faced by Islamic banks.

This section sheds only a brief highlight on the broad primary risks faced in Islamic banking such as credit, market, liquidity, operational and reputational risks as its main focus is on risks that are associated with the governance structure.

As far as credit risk is concerned, Obaidullah (2002) opines that measuring and controlling credit risk is far more important and more difficult. Similar to the conventional bank, credit risk can also lead to liquidity risk. IBs face additional risks, some of which can be traced back to PLS; sales-based debt creating operations; and general disclosure in financial statements as per AAOIFI standard (Alam and Shanmugam, 2007). This credit risk is triggered from Islamic financial instruments particular to Islamic banks, for instance, '*murabahah*' transactions, '*salam*' contracts, and '*mudarabah*' investments and their peculiar working mechanism (Obaidullah (2002).

Ideally, a bank's risk management system should integrate this source of risk with market risks in order to give an estimate of how much the bank stands to lose. Despite that, there exists a general agreement on the Islamic bank's exposure to market risk, which is similar to their conventional counterparts. Similar to market risk, credit risk is triggered by a few risk factors such as mark-up risk, price risk, leased asset value risk, foreign exchange risk, and securities price risk (Iqbal and Mirakhor, 2007).

Liquidity risk in Islamic banks is stems from a lack of liquidity when IBs are unable to meet their liabilities and when IBs cannot borrow when necessary (Iqbal and Mirakhor, 2007). It should be mentioned that liquidity risk is higher in IBs due to the limitations of Islamic products (Askari *et al.*, 2010). Investment risk (Alam and

Shanmugam; 2007), meanwhile, is triggered by investing in equities when there already exist a large proportion of those assets in the IBs. These assets are more *Shari'ah* compliant than *murabahah* financing. It operates in financial environments dominated by the conventional system, thus any changes in interest rates are bound to affect the earnings and asset value. A sharp contrast in PLS based *murabahah*, *istisna*, *ijarah salaam* will involve a mark-up or predetermined rate of return. In fact, a predominant part of the IBs financing is based on these models (Alam and Shanmugam, 2007).

Iqbal and Mirakhor (2007) posit that all risks may come from four overarching categories of risk: financial, treasury, business, and governance. Financial risk comprises credit, market, as well as equity investment risk. For treasury risk, it comprises liquidity risks, asset and liability risk, as well as hedging risk. In addition, business risk constitutes rate of return risk and displacement risk. Meanwhile, governance risk is made up of risks such as *Shari'ah* risk, operational risk, reputational risk, transparency risk and fiduciary risk (Iqbal and Mirakhor, 2007).

For the sake of this paper, the section will highlight the risks that are associated with the IBs' governance structure such as the governance risk, which is a subject matter of the research presented in this study. As *Shari'ah* risk, reputational risk and operational risk are associated with the governance risk, these will all be discussed. It is an attempt to gauge the extensiveness of the effect of governance risks on the Islamic banks. Other additional risks such as displacement risk, withdrawal risk, benchmark risk, rate of return risk, will also be brought to light.

Governance risk

Governance risk is relatively new as compared to other risks, and was picked up quite recently when corporate governance issues are widely discussed. The importance of having corporate governance in place as well as the need to manage risks in dealing with financial crises has made many realise the existence of both corporate governance and risk management. Governance risk occurs when institutions fail in their governance processes, fail due to negligence in their business, or when institutions fail to meet contractual obligations (Iqbal and Mirakhor, 2007).

Governance risk also occurs when internal and external institutional environments are weak due to weaknesses in contract enforcement (Iqbal and Mirakhor, 2007).

It should be noted that theorists have slightly different opinions in terms of what constitutes the governance risk. As for Iqbal and Mirakhor (2007), they view governance risk as the combination of *Shari'ah*, operational, reputational, transparency and fiduciary risks.

Governance risk is associated with *Shari'ah* risk because IB's governance is very much influenced by *Shari'ah* rule through the *Shari'ah* Board. *Shari'ah* risk is very distinct to IB as it stems from there not being a set of universally agreed upon *Shari'ah* standards (Obaidullah, 2002). It occurs when IBs face compliance challenges with *Shari'ah* rulings when there is no standardised way of defining jurisprudence (Greuning and Iqbal, 2008). According to Jobst (2007), *Shari'ah* compliance constitutes a major challenge for the Islamic finance industry in general and risk management in particular. Although *Shari'ah* rulings (*fatwa*) and their underlying reasoning are disclosed, Jobst (2007) adds, that no unified principles (and no precedents) exist as of yet. Quite similarly, Iqbal and Mirakhor (2007) associate *Shari'ah* risk with the structure workings of the *Shari'ah* boards at the institutional and systemic levels. They share similar reasons on the cause of *Shari'ah* risk with Obaidullah (1998) with an additional view (similar to Jobst (2007)) that the *Shari'ah* risk is also triggered by failing to comply with the *Shari'ah*. The different forms of *Shari'ah* rules leads to differences in *Shari'ah* reporting, auditing, and accounting treatments by Islamic banks (Iqbal and Mirakhor, 2007). Banks are exposed to non-compliance risks with respect to *Shari'ah* rules dictated by the *Shari'ah* board and the relevant bodies.

Operational risk

As for the operational risk[38], it is associated with the governance risk through operational processes. Like the mainstream, it relates to the failure of the operational process. There are many ways that operational risk could be triggered, for instance

[38] Operational in Islamic banks operational risk is associated with the loss resulting from "inadequate or failed internal processes, people and system, or from external events, including losses resulting from *Shari'ah* non-compliance and the failure in fiduciary responsibilities" (IFSB, 2005a:26; Izhara and Asutay, 2010).

from ‘cancellation risks’ which arise from non-binding *murabahah* and *istisna* contracts to name a few.

It should be noted that IBs often have a greater exposure to operational risk as they usually have inadequate expertise as well as inappropriate risk systems (Askari *et al.*, 2010). Askari *et al.* (2009) view that operational risk can sometimes be considered part of the reputational risk. The difference is that reputational risk is more subtle than the operations risk as the former deals with intangible items, but they also involve high replacement costs (Askari *et al.*, 2009). Reputational risks arise when IB customers who place a special trust in IB (to fully comply with *Shari’ah*) lose faith in the latter (Greuning and Iqbal, 2008). Thus, unlike the conventional banks, reputational risk faced by IBs is more prevalent as any breach of trust by a single IB can affect the entire institution. As such, close collaboration and standardisation among IB players are among the first steps towards mitigating this risk. Reputational risk also relates to fiduciary risk.

Fiduciary risk

Fiduciary risk is a risk in relation to trust, which is triggered from an institution’s failure to perform in accordance with implicit and explicit standards applicable to its fiduciary responsibilities. It refers primarily to risk that arises when an institution does not operate in accordance with the standards of its fiduciary responsibilities (Iqbal and Mirakhor, 2007). Should there be any divergence from the standards or objectives of the shareholders and the investors, it may lead them to face legal recourse actions of breaches of contract and fiduciary duties towards depositors and shareholders. As such, IBs are expected to act on the best interests of Islamic banks’ stakeholders to adequately manage this risk. In other words, fiduciary risk is caused by IBs violating contracts in the framework setting either through ill-managed funds or non-compliance with the *Shari’ah* principles in their operations (Ahmed, 2009).

Transparency risk

Transparency risk is related to disclosure, which is related to the subject matter of this study. It is triggered when there is an inadequate disclosure of reliable and timely information that provides accurate information on the bank’s position for the public to make an assessment (Iqbal and Mirakhor, 2011).

Commercial risk

When equity holders' returns are subsequently displaced, creating for them a commercial risk, which is triggered when there is a divergence of practice from the theoretical version. It is also reflected in the movement away from PLS activities such as *mudarabah* and *musharakah*, to other modes of financing like *ijarah* and *murabahah* (Hassan and Lewis, 2007). *Mudarabah* and *musharakah* are equity-based and riskier as they involve PLS where the rate of return is not initially outlined (Chapra, 2000). These shifts may even cause risk aversion in conducting asset allocation as well as vulnerability due to liquidity on the liability side. The outcome of this is for there to be dominance in the asset portfolios of short–term, low profit and safe trade related transactions which then reduces the funds which could be invested in more long term, profitable, and riskier endeavours (Chapra, 2000).

Benchmark risk

This relates to market risk. Different from the credit risk, market risk is shown in the trading book. It is due to exposure to changes in the market interest rate through the pricing system for their products. This happens when there is a difference between the margin of domestic rates of return (ROR) and benchmark ROR (Greuning and Iqbal, 2008). Many IBs use external benchmarks such as LIBOR to price, for example, the mark-up in *murabahah* contracts, and thus any changes in the domestic rates will trigger an impact on asset price. Quite similarly to this is the rate of return risk. The rate of return risk is when benchmark rate changes resulting in investment account holders expecting higher rates of return due to a lack of pre-determined RORs (Grais and Kulathunga, 2007). Based on IFSB's (2005:23) definition, it is a risk that relates to uncertainty in returns earned by IBs on their assets.

Additional risk in IBs

As for the additional risks existing in IBs, these include displacement risk, withdrawal risk, commercial risk, and benchmark risk. There are also other risks types such as ownership transfer risks, commodity risks, price or rate of return risks, legal and documentation risks, and *etc.* (Greuning and Iqbal, 2008).

Greuning and Iqbal (2008) defines displacement risk as the risk of losing depositors, which arises when the IB offers ROR funds that are higher than the competitive rate. When this happens, IBs have to forgo its profit which obviously affects its capital (Greuning and Iqbal, 2009). The different pricing of the rate of return in Islamic banks depends on profit, which is shared with the depositors as a predetermined ratio. In relation to this, withdrawal risks occur when IBs are exposed to losing customers to competitors when the banks' rates of return are lower than expectations of what is offered by their competitors. When conventional banks offer pre-determined interest rates to their depositors, the latter may be inclined to withdraw their money from the Islamic banks and place it in conventional banks. In prevailing practices, the risk–sharing advantage does not apply when IBs operate in mixed systems, and pay investment account holders competitive market returns regardless actual performance and or profitability (Solé, 2007). Consequently, the IBs may be pressured to provide returns exceeding the rate earned on assets financed by the depositors when the return on assets does not perform well as their competitors', exposing them to displaced commercial risk .

3.4. CHALLENGES AHEAD

Islamic banks have difficulties in pursuing Islamic risk management. Despite vast numbers of theoretical research on risk management in IBs (Hassan, 2009), the number of empirical studies on risk management in IBs is found to be quite limited (Khan, 1997). Some of the contributing factors lie in the absence of supporting elements to help the systems. This view is shared by many others including Iqbal and Mirakhor (2007), who view that IB has several challenges in pursuing Islamic risk management.

Among the difficulties are in establishing supporting institutions to carry out the risk management functions. For instance, in the case of conventional banking, the legal infrastructure *etc*., are already in place to support them unlike for Islamic banking which does not have these to support them. With respect to infrastructure and resources, IBs may not be have adequate; be they costs, expertise, or technology to support them for the fact that they are small in size and new in the industry. In terms of gaining effective risk management through transparency and high standards of financial reporting, IBs might still be lacking.

Islamic risk management has not been able to compete with the fast and complex innovation in the financial products. This could be due to the intricate techniques used by the products. The capacity of risk management relates to its measuring and monitoring tools (for example, hedging) to gauge risk and this has been outpaced by the innovations of the products. For example, without the offsetting of products which allow investors to hedge investment risks linked to *Shari'ah* products, investors may be reluctant to include *Shari'ah* products in their portfolios.

Based on the current trend, Islamic product development has tried to replicate the mainstream banking system in terms of its product line (Mahlknecht, 2009). This however, may not be cost effective because *Shari'ah* constraints will impose higher transaction costs (Mahlknecht, 2009).

Going back to the many types of measures that can be used to measure risks, VaR is the most widely used, which measures how much a portfolio stands to make or lose. But, this measure ignores what may happen when the risk reaches its peak (Einhorn, 2008), thus may not be the best available solution as yet.

3.5. CONCLUSION

This chapter discussed risk management from the conventional as well as from the Islamic viewpoint. From the conventional aspect of risk management, some conceptual definitions are presented to give insights before the conceptual structure of RM and the rationale for the management of risk is discussed. As the Chapter 3 moves on to the Islamic perspective, more risks are presented. To be able to see the difference between the two perspectives, some insights on how risk management works is highlighted. These include some constraints and limitations in managing the risks.

CHAPTER 4

RESEARCH METHODOLOGY

4.1. INTRODUCTION

The previous chapters review the literature on corporate governance (CG) and risk management (RM) with a particular emphasis on their articulation and practice within the financial system. To facilitate the empirical and analytical study of this research, this chapter discusses the research methodology and the methods it has adopted in conducting the research. Other types of research methodologies are also described so that comparisons can be made between research methodologies. This chapter also elaborates upon the research methods and research tools, and it explains the data analysis approach. The strategy of the qualitative methods, including fundamental assumptions in conducting the research, is also described.

This chapter is presented in seven main sections. Section 4.2 describes the research methodology adopted by the study, while Section 4.3 and Section 4.4 deal with the research design and research strategy respectively. Section 4.5 elaborates on the research method followed by Section 4.6 which explains the data analysis. Finally, Section 4.7 concludes the chapter with the limitations of the study.

4.2. RESEARCH METHODOLOGY

Research methodology refers to the science of studying how scientific research is done through the adoption of systematic problem-solving. Its aim is to describe and analyse methods, reveal their limitations and resources, and clarify the presuppositions and consequences relating to their potentialities to the twilights and frontiers of knowledge (Kaplan, 1973:23).

Sridhar (2008:slide 7) views research as a voyage of discovery or a journey from the known to unknown, an attitude, an experience, a method of critical thinking, a careful critical enquiry in seeking facts for principles, and an art of scientific investigation. It is a process of arriving at dependable solutions to problems through planned and

systematic collection, analysis, and interpretation of data that helps in understanding the products of the scientific inquiry as well as the process itself (Sridhar, 2008:slide 7).

With regards to how research is conducted, Karami *et al.* (2006:43-44) views the debate as being centred on the relative values of two different paradigms the positivist and phenomenological approaches. Logical positivism uses quantitative and experimental methods to test hypothetical-deductive generalizations while phenomenological inquiry uses qualitative and naturalistic approaches to inductively and holistically understand the human experience. (Karami *et al.*, 2006:43-44)

According to the two different types of identified research paradigms, there are two types of research orientations: quantitative and qualitative. Quantitative research assesses behaviour more formally and thus relies on more objective statistical analysis methods, which ensures objectivity (Stangor, 2011). Stangor (2011) sees quantitative data in tandem with qualitative data as more informative as it is fully able to describe observations.

Qualitative research, however, is reliant upon the researcher's understanding of inherent social realities, such as an understanding of observed people and their relationships. According to Patton (1990), qualitative inquiry is useful for studying and understanding people in any situation. Furthermore, qualitative research is explorative and utilises subjective explanations, as it focuses mainly on observations and the description of events in order to fully understand the phenomena at hand (Stangor, 2011).

Using data normally collected through formal observations or measurements, the behavioural aspect of the research helps to discover how people perceive their world. Qualitative research, thus, takes into account that viewpoints and practices in the field are different because of the different subjective perspectives and social backgrounds related to them (Flick, 1998:6).

Research programs always involve human concerns (Stangor, 2011), and research based on the exploration, measurement, and comprehension of human behaviours, by using the collection and analysis of data, can aid in the generalisation process and thus help draw conclusions on human behaviour.

Since the aim of the study is to explore the aspect of social reality that is CG and RM as perceived and conveyed through human behaviour, this study essentially adopts a qualitative methodology. This approach is deemed to be most suitable for this explorative study due to its nature in exploring a particular phenomenon such as the relationship between CG and RM. With regards to boundaries, the scope of the qualitative methodology is confined to obtaining information pertaining to CG and RM in any Islamic banks regardless of location. A clear definition on the limit and extent of this research are indicated (in the subsequent empirical chapters) to ensure its scope remains feasible.

This research is an attempt to explore aspects of CG frameworks in relation to RM in Islamic Banks (IBs). In doing so, it provides answers to the research questions posed at the beginning of the chapter. The applicability of the outcome depends very much on how extensive it dwells with the research questions. For that, the application of the research output is attributed to the depth and breadth of the conducted analysis, factoring in its relevancy in the context of addressing CG issues as well as RM shortcomings as presented in this paper. In other words, since this study aims at studying the nexus between CG and RM faced by IBs through the perceptions of the stake holders as well as from its communicated disclosure, it is constructed, by definition, as a qualitative research methodology.

It is, however, also important to note that the research is extended to go beyond an exploration of CG and RM through disclosure analysis and of CG and RM beyond questionnaire analysis, by incorporating correlation analysis and regression analysis through the data generated by qualitative research. Thus, in the second layer of the research, qualitatively collected data is examined through quantitative methods, as the research aims to examine potential correlations, and determining process through the relevant methods. This makes this study also a quantitative research methodology based research.

In overall, this research, hence, benefits from both the research methodologies in responding to the particular research question developed in relation to this study. Thus, triangulation in research methodology constitutes the general research process related framework in this study.

4.3. RESEARCH STRATEGY

Research strategy is a theoretical structure tested through empirical examination (Collis and Hussey, 2003), which outlines the direction of the study through selecting techniques for specific settings. It is an approach that is not particularly specific to any research design (Saunders *et al.*, 2007).

The importance of research strategy lies in whether the strategy can be guided by the research questions and its objectives which are supposed to be complemented by the extent of existing knowledge, the amount of time and other resources available, and its own philosophical underpinnings (Saunders *et al*., 2009:141).

There are two types of research strategies: deductive and inductive. The deductive approach is when the literature review helps to identify the hypothesis and ideas to be tested (Saunders *et al*., 2007). Thus, the deductive method sees the exploration of data to develop theories related to the literature, despite the defined research questions. Quantitative research builds reasoning through a deductive approach whilst qualitative research builds findings based on inductive reasoning. However, according to Gibbs (2007), qualitative research utilises both inductive and deductive approaches in its explanations.

The inductive approach is used when a researcher wishes to create a relevant hypothesis from the data, relating to the literature, which may lead to a theory (Saunders *et al.*, 2009). Although the research itself is clearly defined with its own aims and objectives, it does not begin with any predetermined ideas (Saunders *et al.*, 2009). Thus, the inductive research strategy involves viewing patterns from the data in order to then develop a hypothesis after the data has been examined.

Despite the fact that inductive research does not require any pre-existing ideas, Stangor (2011) asserts prior knowledge of the subject area is important. Since it is impossible to review every single piece of literature before collecting data, Saunders *et al*. (2009:61) suggests that the study reviews the most relevant and significant research on the topic in its literature review. This research analysis is effective when new findings and theories emerge that nobody has ever thought of before (Saunders *et al*., 2009:61).

According to Patton (1990:40), the inductive approach is an immersion in the details and specifics of data to discover important categories, dimensions and inter-relationships which begin by exploring open questions rather than testing theoretically derived hypotheses. It is an attempt to make sense of the situation without imposing pre-existing expectations on the phenomenon, beginning with specific observations and building towards a general pattern (Patton, 1990:44). Patton (1990:44) elaborates that the inductive strategy is an understanding of program activities and outcomes which emerge from experiences with the setting in which he views theories in the setting as grounded in direct program experiences rather than imposed on the setting a priori through hypotheses or deductive constructions.

Using an inductive research strategy, this study directly starts with the developments in the field and moves on to hypothesis generation and testing. In other words, this research, instead of aiming to test a particular theory with the data collected from the field, first collects the data from the field to explore the diversity or uniformity of the frameworks of CG and RM in IBs. The study analyses corporate governance and risk management-related data from the questionnaires obtained from the respondents of Islamic banks. The objective is to determine whether there is any relationship between CG and RM, of which there is no theoretical or conceptual background per se, to help form the basic building blocks of the relationship.

This study is an attempt to examine relationships between CG and RM as perceived by the participants. There have not been any theories to support the existence of relationships between the variables. The study applies a hypothetical approach to measure relationships. To proceed with, based on scientific and fact observations, as well as reviews of literature, the study presumes the existence of a relationship between CG and RM. This study uses the research hypothesis approach (through hypothesis research design) to examine the relationship between these variables, of which the dependent and independent variables are to be ascertained at this point.

4.4. RESEARCH DESIGN

Research design is the structure in which research takes place (Kothari, 1985) and represents the guiding force behind the execution of a particular research method or

data analysis (Bryman and Bell, 2011). In other words, research design plans how research questions are dealt with.

Research design aims to shed light on problems by first understanding them (Zikmund, 1991), as researchers explore the relevant factors affecting the phenomenon in order to gain a better understanding on the phenomenon. It is a means of finding out 'what' happens, to seek new insights, to ask questions, and to assess phenomena in a new light (Robson, 2002:59) so as to promote further research for more conclusive evidence (Zikmund, 1991). Research design is highly flexible as it does not rely upon pre-existing ideas. Its objective is to identify problems by clarifying the underlying issues which result from the problem's unknown nature. As it is flexible, the design requires researchers to be equally responsive to new data and occurrences. Stangor (2011:69) views research design as different approaches to collect, analyse and interpret data, which are used by researchers in behavioural research. These approaches are grouped into three basic designs: descriptive, correlational, and experimental.

Descriptive research design provides a snapshot of thoughts, feelings, and behaviours at a given place at a given time, which can be based on surveys or naturalistic observations (Stangor, 2011:71). It can be used by both qualitative and quantitative research (Stangor, 2011). However, descriptive studies are viewed as less prestigious (Gummesson, 1991) compared to other designs for the fact that they are usually either mere descriptions of observations, reports, or summaries.

On another note, Gummesson (1991) sees descriptive research as more than just description as this design does not just describe the situation, but it also includes analysis and interpretation. It should also be noted that descriptive studies also help the researcher understand the situation, provide a structured approach to thinking about the study, and give impetus for further research thus helps make decision-making easier.

Experimental research design, on the other hand, assesses how the participant affects the activity, and thus involves measuring how the research influences the participants. According to Saunders et al. (2007), experimental design is sourced mainly from the natural sciences, although it has a strong presence in social science research

particularly psychology. It should be noted that experimental design is aimed at studying causal relations between independent and dependant variables, as opposed to just explaining the relationship. It is able to make use of quantitative data to get a more accurate picture of the relationships and qualitative data to explain the reasons. Experiments are also normally used in these types of research to provide answers to questions of 'how' or 'why'.

Similarly, correlational research design is seen as a research investigation which measures two or more variables and assesses their relationship (Stangor, 2011). The goal of this research design is to uncover variables which demonstrate a systematic relationship with one another (Stangor, 2011), and therefore this may be used with hypothesis testing (Sekaran and Bougie, 2009). The testing is categorised as causal and correlation. This involves causality, when cause of an issue needs to be ascertained, and correlation, when the nature of the relationship needs to be elaborated upon (Sekaran and Bougie, 2009). However, a problem with correlational research is that it cannot identify causality. This has lead researchers to using experimental research to determine causality (Stangor, 2011).

Apart from the descriptive and explanatory approaches, Gummesson (1991) sees exploratory approach as another research design. Exploratory research explores 'why' things occur. It is undertaken to investigate the feasibility of undertaking research or exploring unknown areas (Sekaran and Bougie, 2009). Exploratory research uses both qualitative and quantitative methods to gather data. This allows the data to be triangulated, thus improving the findings' validity and allowing more inferences to be drawn (Saunders et al., 2007). Bryman (2006) agrees with this, and adds that, on the quantitative side, structured interviews and questionnaires in cross sectional research design are more dominant than in the qualitative side.

As for this study, the main research design is the explorative research design, since the study aims to explore the CG and RM disclosure practices in IBs as well as exploring the nexus between CG and RM disclosure practices in the case of IBs. This study uses questionnaires to find 'what are' the frameworks that are observed by the banks. Based on respondents' perceptions from the questionnaires, this study examines all the aspects, or rather dimensions, of CG in trying to see the link with

RM. On the reverse, all aspects of RM are also studied so as to locate whether there is any correlation with the level of practice of CG.

Thus, this study examines how the CG framework in relation to RM helps to govern the IBs from the Islamic perspective. It also analyses how RM frameworks, under the purview of Shari'ah impacts the management of the sampled banks. Thus, theoretically, this study assumes that there exists at least a relationship between these variables.

In addition to exploratory research, in an attempt to analyse the relationships between CG and RM, a correlational research design is also applied to study how CG and RM relate to each other. Using the hypotheses approach, the relationship between these two variables are examined in three different scenarios: whether it is positive, negative, or have no impact on each other. This is conducted through the analysis of responses on CG, which explain the type of relationship.

Furthermore, this study also uses the descriptive research approach to help develop some profiling for the explorative research approach. To a certain extent, the study undertakes the correlational research design to measure the CG-RM relationship through the data generated by disclosure analysis.

In summation, this study is based on an integrated research design including explorative design with the objective of exploring the 'unknown' through questionnaire survey; descriptive research design through disclosure analysis to reveal 'unknown'; and hypothesis testing designs to measure the aspects of 'unknown' through correlational, and regression analysis. Thus, a number of research designs are utilised in conducting this research in an efficient manner in an attempt to respond to the comprehensiveness of the study and its research questions.

4.5. RESEARCH METHOD

A research method is simply a technique for collecting and analysing data, which involves a specific instrument such as a questionnaire (Bryman and Bell, 2011:40). As opposed to methodology, which is the underlying theory and analysis of how research proceeds, research method is a technique and way of proceeding in gathering evidence (Kirsch and Sullivan, 1992:2). However, in quite an elaborated manner, Buchanan and

Bryman (2009) interpret research method by contextualising the method. They view definitions of research methods which denote the process as the seeking of the right tool as out of context as the research method represents more than just a step in research and is not just a tool used to explain approaches deployed in a study.

Buchanan and Bryman (2009) consider research methods an important part of a wider process that helps determine the way in which data may be collected, the nature of the data collected, as well as how the theory may be developed.

Being part of the research design (Bryman and Bell, 2011), research method can either be mono method or multiple methods. The mono method is when a single data collection technique and corresponding analysis procedures are used whilst 'multiple methods' or triangulation involves more than one data collection techniques and data analysis procedures being used (Saunders *et al*., 2009:151).

Mono methods could mean either a combination of single quantitative data collection techniques (such as questionnaires) with quantitative data analysis procedures, or a single qualitative data collection technique (such as interviews) with qualitative data analysis procedures (Saunders *et al*., 2009:151-152).

Multi-methods refer to such combinations where more than one data collection techniques are used. Accordingly, a combination of quantitative and qualitative techniques and procedures for both primary and secondary data is employed. However, this is restricted within either a quantitative or qualitative world view (Saunders *et al*., 2009:152).

Saunders *et al.* (2007) distinguishes the research methods between quantitative and qualitative methods, and categorises them into multi-method quantitative studies and multi-method qualitative studies. The multi-method quantitative study is used when data is collected using, for example, both questionnaires and structured observations with data analysis techniques such as statistical (quantitative) procedures (Saunders *et al.*, 2009:152).

A multi-method qualitative study on the other hand, uses qualitative data collection techniques, for example an in-depth interviews and diary accounts, and uses data analysis techniques, for example in non-numerical (qualitative) procedures (Saunders

et al., 2009:152). In essence, a multi-method does not mix quantitative and qualitative techniques and procedures.

In relation to research design, Saunders *et al.* (2009:151-152) also classifies design based on methods. According to him, research design can be classified into two types of methods: mixed methods and mixed models. The mixed method is used when both quantitative and qualitative data collection techniques and analysis procedures are used in the research design. Mixed method research uses quantitative and qualitative data collection and techniques and analysis procedures either at the same time (parallel) or one after the other (sequential) but does not combine them. This means that although mixed method research uses both quantitative and qualitative methods of data collection and analysis methods at the research methods stage, quantitative data is analysed quantitatively and qualitative data is analysed qualitatively. Normally, either a quantitative or qualitative technique will dominate.

In contrast, mixed model research combines quantitative and qualitative data collection techniques and analyses procedures as well as a combination of quantitative and qualitative approaches at other phases of the research such as research question generation. This means that researchers may take quantitative data and 'qualitise' it, *i.e.* convert it into a narrative that can be analysed qualitatively. Alternatively, researchers can 'quantitise' the qualitative data, *i.e.* convert it into numerical codes so that it can be analysed statistically Saunders *et al.* (2009:151-152).

This study in particular uses a mixed method approach for its data collection. The primary data is gathered through the quantitative data collection technique of questionnaires. Being qualitative in nature, the responses from the sample population are quantified for analysis by the statistical data procedures. Primary data for this study is collected via the questionnaire technique to gather a snapshot of the understanding and perceptions from individuals who have relevant information on corporate governance and risk management in IBs. This is to understand the basis of the phenomena of the exploratory study, of which, the thought and behaviour of the individuals pertaining to corporate governance and risk matters are collated.

This study also uses secondary data from various sources such as: Annual Reports, financial statements, literature reviews, and case studies. It employs a mixed model

approach that uses qualitative data from the questionnaires and Annual Reports and analyses them using data analysis techniques. Thus, by doing so, qualitative data is quantified using their respective analysis procedures to be analysed statistically. The study undertakes a mixed model approach

Through the descriptive design, the study gathers data such as behaviour and perceptions of the individuals in IBs through questionnaire. Data is collected via questionnaires to gather a 'snapshot' of understanding and perceptions from the individuals who have relevant information on CG and RM in IBs. This is done to understand the basis of the phenomena of the exploratory study, of which the thoughts and behaviour of the individuals pertaining to CG and RM matters are collated. The descriptive design acts as a preparatory stage for subsequent exploratory design purposes. The secondary data obtained from the annual reports is used in the hypotheses approach to help identify the relationship between the CG and RM of the individual IB. Finally, the design is also employed to use this secondary data from various sources to analyse case studies and review the literature. The case studies and review of literature provides a content analysis for relationship between CG and RM.

The following section first focuses on the aspects of the questionnaire survey methods, which is followed by a disclosure analysis.

4.5.1. Data Collection: Questionnaire Survey

Surveys may include semi-structured interviews and telephone and online questionnaires, which are often used in deductive approaches (Saunders *et al.,* 2007). It should be noted that, in general, survey data is sometimes limited and subject to the willingness of the respondents (Tashakkori and Teddlie, 2003). However, Saunders *et al.* (2007) view that surveys have more control over the research process and sampling may allow data collection representative of entire population at a fraction of the cost.

This study uses a questionnaire survey as one of the strategies for data collection, which comprises a cross-sectional design in relation to which data is collected predominantly by questionnaire or by structured interview (on more than one case and at a single point in time) in order to collect a body of quantitative or quantifiable data

(in connection with two or more variables) which is then used to identify patterns in the relationship (Bryman and Bell, 2011:54).

4.5.1.1. Questionnaire

Questionnaires are a survey technique that is used to collect data in which individuals are asked to respond to the same set of questions in a predetermined order Saunders *et al.,* 2009:360). It is considered a powerful tool which is able to yield the maximum amount of information in the most efficient way (Gummesson, 1991). The advantages of a questionnaire include that they need less skill and are less sensitive to administer than face-to-face methods of data collection (Saunders *et al.,* 2007).

Gummesson (1991) suggests that it is enough to use only questionnaires as the data collection method although is often better that it be linked to other methods in a multiple–method research design. For instance, a questionnaire used alongside a semi-structured interview to contextualise individual perspectives. Questionnaires need to be completed by participants either by themselves or with a guiding hand **(**Glăveanu, 2008). Unlike interviews, questions in a questionnaire must not stray from the schedule.

Saunders *et al.* (2007) views that questionnaires work best when questions are standard and are suitable for use in explanatory and descriptive research designs. Descriptive research that discovers attitudes and opinions through questionnaires are useful for identifying the variability of phenomena while questionnaires in explanatory or analytical research are useful for examining correlation relationships. According to Saunders *et al.* (2007), however, questionnaires see limited use in exploratory research or when there are large amounts of open-ended questions. He consider it as a less useful instrument for the study of processes due to the rendering of cross sectional data as happening at one point in time rather than perceiving the social reality as a process.

Since this research is also an exploratory and descriptive research in terms of its design, the questionnaire is considered as one of the main research methods in collecting the required qualitative data (in the form of opinions and perceptions) to respond to the identified research questions.

It should be noted that there were difficulties in getting responses from the sampled banks' employees through questionnaires due to reasons such as confidentially, time constraints, unwillingness, *etc*. Apart from this, due to budget constraints, convenience, easy access, the method being flexible and hassle-free, and freedom (no obligations imposed on respondent) an unobtrusive method of disclosure analysis is chosen.

To ensure that the sample is representative, there are certain techniques to be considered such as the when, type, and choice of questionnaire. The type of questionnaire will affect the number of people responding to the questionnaire. For instance, interviewer-administered questions will usually have a higher response rate than self-administered questionnaires. The size of the sample and the way the sample is selected affects the credibility or the confidence of the collected data as well as to what extent their responses can be generalized. Furthermore, longer questionnaires are normally used in a structured interview. In essence, the choice of questions in the questionnaire will have to be aligned with the research questions and objectives of the study.

4.5.1.2. Sampling

Questionnaires need to be precisely designed to be able to provide answers to the research question. This is because it almost impossible for a researcher to collect data a second time as it may be difficult to find the same respondents again, especially if they are anonymous.

Sampling is used in research to determine the characteristics of a population as it is usually impossible to use the whole population as a sample (Stangor, 2011). This makes it difficult to determine the true characteristics of the population (Stangor, 2011). In evaluating research, Black (2002) lists several groups of participants to be chosen for participation in a study: a whole population, a randomly selected sample, a purposely selected sample from a population, or volunteers and unspecified groups. There can also be combinations of groups to select the participants from.

In exploring the uniformity or diversity of the frameworks adopted by IBs, the study utilises a sampling approach to collect data on CG and RM-related matters. It uses a combination of randomly selected groups as well as a purposely selected group

sample. This is because the random samples are the ones from the operations level who can provide data pertaining to the implementation of corporate governance and risk management practices. The purposely selected samples, on the other hand, are the individuals who are in between the levels of senior management and the board of directors as they are expected to be able to provide data specifically on policy matters vis-à-vis the ones that deal in the operation aspects.

Sampling can be done either through probability sampling or non-probability sampling. In probability sampling, everyone in the population has a known chance of being included (Stangor, 2011). Probability sampling is more likely to be representative. However, samples may only become truly representative if two conditions are met. Firstly, there must be more sampling frames that list the entire population of interest and secondly all the selected individuals must then be sampled (Stangor, 2011). If these conditions are not met it will lead to a sample bias (Stangor, 2011). The probability methods can be classified into: simple random, systematic random, stratified, and cluster sampling while non-probability sampling includes snowball sampling and convenience sampling (Stangor, 2011).

In non-probability sampling, the sample frame does not exist. The snowball sampling of a non-probability sample is used when it is difficult to reach members of the population. Even if a complete sample frame is available, if all members of the random sample frame do not participate, it risks creating a sampling bias. Other types of non-probability sampling include: quotas, self-selection, convenience, and purposive sampling (Saunders *et al*., 2009:236). However, purposive or judgemental sampling requires judgement in selecting cases that can best provide answers to the research questions (Saunders *et al.,* 2009:237). Thus, even though this sampling runs the risk of not being representative, it benefits by being able to focus on key themes as it selects cases depending upon its research questions. It thus allows for homogeneous sampling when the survey is focused on a group in which all sample members are similar. This provides an in-depth analysis of the issues.

This study uses the non-probability sample of purposive sampling. Ideally the whole population of IBs could best be used to examine the CG-RM relationship. However, this is not possible hence the research uses purposive sampling in order to be able to reach potential respondents in an efficient manner. In this case the sampling is chosen

regardless of its location but fully based on the judgment of whether the sample is a financial institution that provides Islamic products and whether the individual respondents are well aware of the CG and RM issues in their respective IBs. Thus, he/she should be able to provide answers for the research questions. Therefore, questionnaires were sent to the relevant departments in a number of IBs who were identified through different sources as the best people who were able to respond.

4.5.1.3. Questionnaire Design: Types of Questions and Level of Measurement

The layout and presentation of the questionnaires drastically affect the response rate. There are two types of questions: Open-ended questions and closed (or forced choice) questions. Open-ended questions help with exploratory research, particularly when working with an unknown range of respondents (Zikmund, 1991). However, open-ended questions risk unclear responses, which are too difficult to be analysed. Zikmund (1991) claims that open-ended questions are effective since respondents are free to answer according to their thinking, thus allowing for the most 'flavour' despite exposure to interviewer bias.

Closed-questions allow data collection to be done in a much shorter time as compared to opened-questions. It is easier to make specific comparisons between people when everyone is asked the same questions and everyone is restricted to a particular set of responses (Gomm, 2004). However, Gomm (2004) also states that this forces the respondents to agree with at least one of the choices given, which may lead to misinterpretation.

To help respondents form opinions, this research uses closed-ended questions, which are constructed using Likert Scales. Except for one, all the questionnaires are guided by the scale to form their opinions in stating their responses. The Likert Scale is used to provide options for the questions as it assists the respondents to express their preference in scales. It comprises a five-point scale which is labelled thusly: 'strongly disagree', 'disagree', neutral', 'agree' and 'strongly agree'. For the one dichotomous question of the questionnaire, respondents are guided to form their opinions by ticking 'yes' or 'no' as a categorical question.

It should be noted that the design of the questionnaire was specifically deliberated to reduce the number of statements in the questionnaire without compromising the

comprehensiveness of the framework, which could affect the reliability and credibility of the data.

Appendix 1 presents the questionnaire schedule used in this study to provide an understanding of the extent of enquiry conducted in this study.

4.5.1.4. Design Requirement

Prior to selecting the appropriate characteristics to obtain answers to the research questions in trying to achieve the thesis objectives, a thorough review of literature is needed. This is when issues and the gap analysis highlighted in the literature review are linked to the research question, *i.e.* by deliberating upon the questions posed in the questionnaire. Questionnaires are designed to narrow down the gap to meet the research objectives. There are three types of questionnaire design: 'structured interview', 'interview-administered questionnaire', and 'self-administered questionnaire'.

The structured interview, also known as the interview schedule, is regarded as another type of questionnaire where the interviewer questions the respondents in person. This is different to a semi-structured and unstructured interview (in depth) as the interviewer must not stray from the predefined set of questions. For the interviewer–administered questionnaire, responses of the interviewees are recorded by the interviewer. The self-administered questionnaire expects the respondents to complete the questionnaire. This study uses the self-administered technique of the questionnaire.

Explanatory research needs data to test a theory. This means, according to Saunders *et al.* (2007:361), in addition to the issues highlighted for descriptive research, there is a need to define theories that one wishes to test as relationships between variables prior to designing the questionnaire. In other words, conceptualising the research prior to designing the questionnaire is required, especially in terms of relationships between variables, *i.e.* dependent, independent, and extraneous variables so that the types and nature of data needed should be identified before the design of a questionnaire. Thus, they suggest that these variables are to be tested through a statistical analysis of the data collected by the designed questionnaire of which the details should be reasonably clear since the variables will be measured at the design stage.

There are three types of variables that can be collected through questionnaires: opinion, behaviour, and attribute (Saunders et al., 2007:362). The 'opinion' variable records how respondents feel about something or what they think or believe is true or false. In contrast, data on 'behaviour' and 'attribute' records details of the respondents. The 'behaviour' variable contains data on what people do in the past or will do in the future, while the 'attribute' variable contains data about a respondent's characteristics. Attributes are best thought of as 'what' a respondent possesses rather than 'what' a respondent does (Saunders et al., 2007:362). Variables are used to explore 'how behaviour and opinions differ between respondents' as well as to check that the data collected is representative of its total population.

This study mainly involves the 'attribute' and opinion variables as most of the responses gathered from the respondents are based on what the IBs possess or the consideration of the respondents on their respective IBs' positions on identified CG and RM issues. However, to a certain extent, the 'behaviour' variable is also applied when the respondents relate their answers to past experiences. Through the questionnaire, the qualitative information gathered is in the form of quantitative data.

It should be noted that the assembled primary data is used to gauge the level of CG and RM practices in Islamic banks through questionnaires. In this approach, the selection and development of the questionnaire is underlined by the theoretical framework of CG and RM. In other words, the theme, dimensions, and qualifier statements are based on CG and RM frameworks. The theme, dimensions, and qualifier statements, which act as the checklist, take into account the CG and RM principles from the *Shari'ah* perspective, which also, in one way or another, cover the CG and RM principles from the conventional perspective of the financial system. As a matter of fact, the CG and RM principles used in this research are based on the combinations of guidance spelt out by AAOIFI (2002), IFSB (2006), OECD Report (2004), and many others.

The design of the questions in the questionnaire used in this study is based on the conclusions drawn from the literature review. Resources such as articles, journals, PhD theses, and books that discuss the topics of CG and RM are used to substantiate the conclusion from the literature review. Thus, to fill the gap analysis as highlighted

in the literature review, this study designs the questionnaire. It comprises 2 segments, CG and RM, of which each segment is designed to gauge its respective area.

4.5.1.5. Development and Layout

To uphold the theoretical frameworks of CG and RM, the questionnaire is segmented into two parts: CG and RM. CG and RM have 6 and 5 dimensions, respectively. Each dimension of CG and RM has a varied number of statements (also known as constructs or qualifying statements). The layout of the questionnaire is as summarised in Table 4.1, and the entire layout can be found in Appendix 1 with detailed constructs.

Table 4.1: Layout of Questionnaire

Part	Dimension	Number of Statement
Corporate Governance	Board of Directors	17
	Structure, Committees and Senior Management	15
	Disclosure and Transparency	7
	Audit	7
	Policies and Procedures	12
	Support and Operations	8
Risk Management General	Risk Management (General)	19
	Credit Risk	11
	Market Risk and Liquidity Risk	15
	Operational Risk	6
	Shari'ah Risk	6
Total constructs		123

In the CG segment, the first part tests whether the board is fit and proper in performing their roles and responsibilities while the second part examines the appropriateness of the structure and the committees as well as the effectiveness of the senior management. The third part examines the disclosure and transparency aspect, and the fourth part looks into audit matters while the fifth part tries to gauge the adequacy of the policies and procedures. Finally the sixth part examines the effectiveness of support and operations of the bank. The RM segment starts by examining the general risk management practices. The subsequent parts analyse the respective 'credit risk', 'market and liquidity risks', 'operational risk' and '*Shari'ah* risk'.

4.5.1.6. Administering the Questionnaire

This research uses a self-administred survey that uses a purposely selected group. In the beginning, slightly more than 100 samples were expected to be included for the survey.

Table 4.2: Sample Banks for Questionnaire

Country /Locality	Number of banks	Bank Name
Indonesia	11	Not specified (11)
Malaysia	8	AFFIN
		BIMB
		OCBC
		RHB
		Not specified (4)
Pakistan	1	Meezan
Qatar	1	QIB
Turkey	4	Albaraka
		Asya
		KuveytTurk
		Turkiye Finans
UK	3	BLME
		EIIB
		Gatehouse
Total	**28**	

The questionnaires were distributed to people in specific IBs through their emails as sampling was done based on the availability of their email addresses obtained from the internet. The questionnaires were sent out to the IBs' employees. In some cases, the questionnaires were sent to more than one employee per bank when no response was received for the questionnaire that was sent earlier. Initially, when the questionnaires were first sent out, the responses were expected to be received within two months. However, since the response rate was very poor, the deadline for the responses was extended to another two months. It is for the same reason that the deadline was extended several times in the duration of a one and a half year period. Despite the time flexibility given for the submission of the questionnaires, the research finally settled with 28 responses after only about one year.

In the end, questionnaires were received from the following countries and banks, as depicted in Table 4.2.

4.5.1.7. Data Evaluation

Qualitative research often entails a form of cross-sectional design (Bryman and Bell, 2011:57). Quite often, cross-sectional studies in business and management tend not to be clearly divided into those that use either quantitative or qualitative methods (Bryman and Bell, 2011:57). As most ideas relating to data quality were developed with quantitative research in mind, there are questions as to whether or not it is possible to evaluate the quality of qualitative data or whether there are equivalent techniques to ensure the quality of data and the quality of qualitative research (Gibbs, 2008:91). According to Bryman and Bell (2011:41), three of the most prominent criteria for the evaluation of business and management research are reliability, replication and validity. Flick (2008), however, sees that there is no simple way of checking the validity of qualitative research. He also opines that evaluating research quality in the context of qualitative analysis is controversial, with respect to the how reliable, replicable, and valid the research is, as he states that the qualitative researcher cannot claim to be impartial.

On a similar note, Bryman and Bell (2011:57) view that where research is not necessarily preoccupied with such criteria of quantitative research as replicability and internal and external validity, considerable care can be taken to ensure the representatives of the sample (in relation to the overall population). They view that a triangulated approach where attempts are made to cancel out the limitations of one method by the use of another in order to cross-check the findings can be used to measure up in terms of evaluating the criteria of reliability, replicability, and validity.

One of the most damaging limitations is that survey by postal questionnaires often results in a low response rate (Bryman, 2012:235). This study employs a triangulation approach that uses content analysis as another data collection method to strengthen its findings. A triangulation approach is used to increase the validity of the research (Bryman and Bell, 2011).

Unobtrusive data collection methods for disclosure analysis through the content method are discussed in the following section. To better inform the research process, a reliability analysis for the questionnaires through Cronbach's Alpha (α) using SPSS was conducted and the results are presented in Table 4.3. A Cronbach's Alpha test

was run on a sample size of 28 IBs where 122 statements from the questionnaire are checked for their reliability and internal consistency. Internal consistency describes the extent to which all the items in a test measure the same concept or construct and hence it is connected to the inter-relatedness of the items (Tavakol and Dennick, 2011). The result in Table 4.3 (Reliability Statistics), show that the Cronbach's Alpha is 0.986, indicating there is high level of internal consistency.

Table 4.3: Reliability Test Analysis

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.984	.986	122

4.5.2. Unobtrusive Data Collection for Disclosure Analysis

This study was initially designed to collect the entire data set through questionnaire survey design. However, the collection of data from IBs proved to be very difficult and also due to the fact that only 28 questionnaires could be collected, a change in the research methodology, design and method was inevitable to provide a more efficient and effective empirical research. For this, reason, disclosure analysis was considered to substantiate the questionnaire based analysis. In the disclosure analysis, the research utilises secondary data in the form of IBs' annual reports to gauge how much information the banks disclosed in relation to the index created as a best practice. Thus, the same research questions were considered to be tested through the data collected through a content analysis of the annual reports of Islamic banks for the disclosure analysis. This unobtrusive research method is discussed in this section and the method of estimation is presented in Chapter 6.

It should be noted that content analysis is now a widely used method of analysis in financial accounting research (Beattie; 2005). As evidenced in recent years, the use of content analysis and its significant issues has been discussed by several studies (Beattie, 2005). This study uses secondary data to complement the primary data obtained through the questionnaire through content analysis in conducting disclosure analysis.

This research, hence, employs content analysis to examine the strength of the CG-RM relationships using the information provided in the annual reports to explore the

communication aspect of the IBs. In the disclosure approach, the index for the respective CG and RM is constructed in terms of best practice and the information that IBs release in their annual reports was sought to provide responses to the established best practices dimensions and constructs.

The dimensions included in the disclosure index for CG and RM are presented in Table 4.5 with the number of statements or constructs included in each dimension. The detailed indices for both CG and RM with all the constructs can be found in Appendix 2.

A total of 53 IBs are taken as a sample to represent different regions. From the 53 IBs, a collection of 181 online versions of annual reports from the years: 2007, 2009, 2011 and 2012 are included. For banks that do not have ARs of these years, the sample banks' annual reports between the years 2003 and 2012 are examined. The data is primarily gathered from online published annual reports of the IBs from their individual websites. There are compilations of financial statements and risk management reports which are also used to analyse CG and RM as lack of standardisation prevents the efficient collection of secondary data. Besides that, data from various sources such as Islamic banking magazines, online articles, and web-pages are also gathered to complement information gathered from the annual reports. The sample banks are as shown in Table 4.4.

In terms of sampling, the annual reports are chosen based on the criteria that: they have to be from Islamic financial institutions, they have to be available online, and they have to be published in English between certain years of the 2000s.

To examine disclosure from the annual reports, the data from the reports are tabulated based on a specific worksheet. The worksheet comprises 9 themes grouped into 15 dimensions (8 dimensions for CG and 7 dimensions for RM) and codified into 135 constructs. The CG index with its 8 dimensions has a total of 75 constructs while RM with its 7 dimensions has 60 constructs (please see Table 4.5 for the number of constructs for each of the dimension).

Table 4.4: Sample Banks' Annual Reports

No.	Country	No.	Bank	No.	Country	No.	Bank
1	Bahrain	1	ABIB	8	Pakistan	28	Al-Falah
		2	Bahrain Islam.			29	Meezan
		3	As-Salam			30	Bujr (Daw.)
		4	Khaleeji	9	Qatar	31	QIB
		5	Ithmaar			32	Rayan
		6	Eskan			33	IBQ
		7	ABCIB			34	QIIB
		8	Capinnova	10	Saudi Arabia	35	AlRajhi
		9	KFH			36	AlJazira
2	Bangladesh	10	S.Jalal			37	AlInma
		11	Islami			38	Jadwa
		12	Al-Arafah	11	Sudan	39	Al-Shamal
3	Egypt	13	Faisal			40	Albaraka
		14	Albaraka			41	Faisal
4	Indonesia	15	Muamalat	12	Turkey	42	Albaraka
		16	BSM (Sy.M.)			43	Asya
		17	BNI Syariah			44	KuveytTurk
5	Jordan	18	JIB	13	UAE	45	ADIB (A.Dh)
		19	IIAB			46	DIB (Dubai)
		20	JDIB			47	Hilal
6	Kuwait	21	Boubyan			48	Emirates Isl.
		22	Kuwait Intern.	14	UK	49	Gatehouse
7	Malaysia	23	BIMB			50	BLME
		24	CIMB			51	IBB
		25	RHB			52	EIIB
		26	Affin	15	Yemen	53	Tadamon
		27	HLIB				

The themes included are: 'bank mission', 'board effectiveness', 'effective committees and senior management', '*Shari'ah* governance and compliance', 'ethical business conduct', 'audit', 'risk governance and practices', 'reporting and accounting', and 'risk control'. Each theme may comprise of one or more dimensions.

The 9 themes are extended into the following dimensions: 'mission', 'composition of the board of directors', 'board leadership', 'board meetings', 'nomination and compensation committee', '*Shari'ah* governance', '*Shari'ah* compliance', 'ethical business conduct'; 'audit committee', 'risk management committee', 'risk management control and disclosures', 'reporting and accounting', 'market and liquidity risks', 'credit risk', and 'other risks'. Each dimension is denoted by D1 through D15.

Table 4.5: Dimensions in Disclosure Index for CG and RM

Part	Dimension	Number of Statement
Corporate Governance	Mission	7
	Composition of the BOD	9
	Board Leadership	3
	Board Meetings	2
	Nomination Committee or / and Compensation Committee	11
	Shari'ah Governance	12
	Shari'ah Compliance	18
	Ethical Business Conduct & Corporate Responsibility	13
Risk Management	Audit Committee	22
	Risk Management Committee or / and Asset Liquidity Committee	6
	Risk Management, Control Items & Risk Disclosures	10
	Reporting - Accounting and Funding	9
	Market and Liquidity Risks	6
	Credit Risks	5
	Other Risks	2
Total		135

The theme 'board mission' consists of the 'mission' dimension (D1); the theme 'board effectiveness' consists of the 'board composition' (D2), 'board leadership' (D3) and 'board meetings' (D4) dimensions; the theme on 'effective committees and senior management' consists of 'nomination and compensation committee' (D5); the theme on '*Shari'ah* and compliance' consists of '*Shari'ah* governance' (D6) and '*Shari'ah* compliance' (D7); the theme on 'ethical business and practices' consists of 'ethical conducts' (D8); the theme on 'audit', consists of 'audit committee and audits' (D9); the theme on 'risk governance' consists of 'risk committees' (D10) and 'risk management and control items' (D11); the theme on 'reporting and disclosure' consists of 'audit' and 'reporting' (D12); and the theme on 'risk control' consists of 'market and liquidity risk' (D13), 'credit risk' (D14) and 'other risks' (D15).

Each dimension has a varying number of statements, which are also known interchangeably as constructs, of which the statements act as qualifiers to identify the presence or absence of specific items pertaining to CG and RM.

Based on the above worksheet, the CG and RM indices are developed by basing them on a weighted average formulated through a series of worksheets. In summary, the general layout of the worksheet is shown in Table 4.5.

As mentioned, the calculation method is presented in Chapter 6, which provides the empirical results developed through the disclosure analysis. In addition, further explanations related to the estimation method are provided in the following section.

4.6. RESEARCH METHOD: DATA ANALYSIS

This section aims to highlight the methods and tools, which are used for data analysis and is separated into two sections that represent the Perceptions Analysis based on questionnaire and Disclosure Analysis based on secondary data.

Table 4.6: Summary of Data Analysis Methods

Perceptions (Questionnaire)		**Techniques/Tools/Method**	**Application**
Descriptive / Inferential		Likert-scales Cronbach's Alpha Frequency & Descriptive Tables Kruskal Wallis	Excel SPSS
Statistical	Correlation	Spearman's Rho Pearson Correlation	
	Regression	ANOVA Correlation Coefficient	
Disclosure (Annual Report)		**Techniques/Tools/Method**	**Application**
Descriptive / Inferential		Likert-scales Mean	Excel
Statistical	Correlation	Spearman's Rho Pearson Correlation	SPSS
	Regression	ANOVA Correlation Coefficient	

The software applications and tools used to analyse the two sets of data are summarised as shown in Table 4.6.

4.6.1. Perceptions Analysis

For the perception analysis, the research first utilised the purposive sampling questionnaires to gauge the respondents' perceptions on various facets of CG and RM, which manifested as constructs within the questionnaire. These constructs are designed using a Likert Scale which allows respondents to indicate their level of agreement/disagreement with the given statements, *i.e.* their perceptions of their banks with regards to matters of CG and RM. The use of the Likert Scale allows the research to quantify the data. The quantified data from these questionnaires are then tabulated into frequency and descriptive tables (using Microsoft Excel) in which the means for the Likert Scale scores are calculated and used to describe the data. The data is also checked through Cronbach's Alpha for reliability. Then the Kruskal-Wallis Test as a non-parametric test is used to compare the results in the form of a mean difference analysis from the findings using the SPSS software. Next, for the statistical analysis, most of tools used are from the SPSS software. To measure correlation between CG and RM, the Spearman's Rho (non-parametric) and Pearson Correlation (parametric) tests are used. Then, ANOVA was used to measure the regression of the data in terms of how much the dependent variables (CG and RM) are able to be explained by their respective dependent variables (dimensions).

4.6.2. Disclosure Analysis

In terms of the collected annual reports, the availability of the annual reports from each bank ranges from 1 annual report per bank (at minimum) to 4 annual reports per bank (at maximum). These annual reports are then analysed to determine if certain elements of CG and RM (that would be expected of an IB as spelt out in the constructs) are disclosed in the IBs' respective annual reports. The expected elements are recorded in an Excel table as either present or not present and quantitised by defining a present element as having the value '1' and a non-present element as having the value '0'. This is done for at least one up to four years of annual reports for each bank. The scores for each year are then calculated using Excel sheet to find the means for each bank as well as for the years. These means (weighted) are then used to develop an index from which the descriptive portion of the disclosure approach derives its analysis.

For the statistical portion of the research, the results from the index are run in the SPSS software using various statistical methods. Similar to the perception approach, the Spearman's Rho (non-parametric) and Pearson Correlation (parametric) test are used to measure the correlation between CG and RM, followed by ANOVA, which is used to measure the regression of the data in terms of how much the dependent variables (CG and RM) are able to be explained by their respective dependent variables (dimensions).

4.7. LIMITATIONS AND DIFFICULTIES

Data collection from IBs appears to be the most challenging issue in this research. Insufficient or unavailable data is something that is very much unavoidable. According to Dolton *et al.* (2006:439), "Nonresponse is a commonly encountered phenomenon in social surveys. Whether nonresponse affects statistical analysis of the survey data depends on the variables one is interested in".

The fear of not getting sufficient data was realised in the later part of this research process. In light of its time frame, the research painstakingly struggled to obtain the responses before the research could proceed further with the data analysis part. However, despite all efforts only 28 responses were received for its questionnaires. At the onset, this research aimed to get at least 80 responses from the questionnaire method. Through emails, more than 120 questionnaires were sent out to IBs in the Middle East, Germany, UK, Pakistan, Bangladesh and Malaysia. However, only about 6% of the IFIs responded while most of the responses received were obtained via the supervisor and colleagues. Thus, another research strategy was devised.

On the verge of the approaching timeline, an alternative data collection method, or rather an additional research method was considered. The research opted for an unobtrusive data collection, *i.e.* getting secondary data from the IBs' annual reports (see Appendix 2). The research design was slightly changed to cater for the secondary data collection which is based on the disclosure approach. Nevertheless, the disclosure approach did not proceed without its own problems. As the actual work begun, it became clear that the vast majority of banks do not have their annual reports published online, especially for the four selective years as required by the research. Even though at the beginning the research expected to use 200 IFIs as its sample, this

did not materialise since not many banks fulfilled the required criteria. These criteria were that the IBs had to have published annual reports online, the IBs had to have an English version annual report, and they had to be Islamic financial institutions.

Hence, it can be said that generally the data gathering process for this research was a real challenge. Nevertheless, for most of the parts, the research methodology used was deemed suitable to continue on with the study at this juncture.

CHAPTER 5

MAPPING CORPORATE GOVERNANCE AND RISK MANAGEMENT DISCLOSURE PRACTICES IN ISLAMIC BANKING: DISCLOURE ANALYSIS

5.1. INTRODUCTION

One of the most profound traits of Islamic banking (IB), as explained in the earlier chapters, is its ethical foundation, and ethicality in contemporary times is not limited to the ethical nature of businesses but also the disclosure of activities as stipulated by international agencies. As far as ethics is concerned, the Islamic banks (IBs) are encouraged to disclose pertinent information to stakeholders when doing business, as necessitated by the governance of Islamic principles in the sense of revealing the necessary information for stakeholders and shareholders to help in their decision making processes. Hence, the disclosure approach is used to validate the information they have provided via their communications through mediums such as the annual report. When information such as corporate governance and risk management is disclosed, this helps improve the stakeholders' understanding of the bank's nature of business, current state of affairs, and their future plans, thus strengthening the bank's credibility.

This chapter extends the literature on the relationship between corporate governance (CG) and risk management (RM) from the disclosure perspective. The aim of the chapter is to present the results of the content analysis in order to analyse the relationship between CG and RM whereby CG and RM disclosure levels are measured. In addition, this chapter also aims to explore IBs' ethicality in their communication via annual reports to investigate the nature of disclosure and to what extent this is revealed in their ARs. This chapter, thus, is an attempt to provide some observations on CG acceptance and RM practices in Islamic Financial Institutions (IFIs).

As identified, the relationship between CG and RM in this study is examined based on the banks' disclosure as communicated through their annual reports. As mentioned earlier, the disclosure approach uses an index to examine the CG-RM relationship. Besides identifying relationships, it is hoped that the most significant components of CG and RM can be identified through the index.

5.2. EMPIRICAL MODELLING

As mentioned, the data for measuring the relationship between CG and RM through disclosure analysis are collected through a content analysis of sampled annual reports of IBs for the years 2007, 2009, 2011 and 2012[39]. For banks that do not have any annual reports for the four mentioned years, a minimum of one year and maximum of 4 years annual reports between the years 2003 and 2012 are considered.

In conducting the coding analysis as part of content analysis, to ensure reliability and validity, annual reports are read with emphasis placed on CG and RM-specific aspects. The approach to scoring items, as mentioned in the Research Methodology chapter, is dichotomous, that is to say the score is either 1 if present or 0 of otherwise. The scoring is additive in nature where the index is constructed based on a weighted average, as simplified below:

$$Index_j = {}^{n}{}_{j}\sum_{t=1} X_{ij}/n_j \qquad (5.1)$$

where,

$Index_j$ is the index, n_j is the number of constructs disclosed by j^{th} IB, $n_j <= 135$[40], and x_{ij} =1 if i^{th} construct is disclosed (0 if i^{th} construct is not disclosed), so that $0 <= I_j <= 1$.

This model is identical to the one developed by Haniffa and Hudaib (2007). Generally, an index is derived by taking into account its total score, which is divided by 135 *i.e.* the total number of constructs, as explained in the Research Methodology chapter.

[39] Different IBs might have different combination of years of annual reports - depending on the availability of the annual reports. For example, it could be a combination of years 2007, 2009, 2010, 2012 *etc*.

[40] The number 135 represents the total number of constructs in the disclosure worksheet.

By using this particular formulation in equation 5.1, each index is constructed individually according to IB and country.

The scores obtained by each IB are recorded in the respective bank's table, which can be seen in Appendix 5 as a template. The table shows scores for each year of the annual report (depending on how many annual reports the bank has) where the bank's score for each year is added up to give the individual IB its total score for all the years; see Appendix 2.

Each IB's total score is calculated based on the above formula and is split according to the dimensions. To derive the 'Dimension Index' (D), the score of each dimension is divided against the total number of statements in that dimension. Then the index is tabulated, taking into account the total number of Annual Reports the IB has (see Appendix 2).

Constructing the CG Index

The construct of CG Index **(**CGI) is based on the total scores the bank obtains in its dimensions from D1 through D8 against the total number of constructs, also referred to as qualifying statements (QS), totalling to 75 taking into account the number of annual reports' years. This construct applies to each individual sampled bank in each individual sampled country, referred to as the 'Bank CG Index'. The mean Bank CG Index is derived by adding up the CGI for all the banks divided by the number of banks.

The CG index is also constructed for each country, referred to as the 'Country CG Index'.

The Country CG Index is constructed based on the total scores of each individual bank obtained for dimensions D1 through D8, taking into account the number of annual reports periods or years. For example, if the bank has a 4-year series of annual reports then all the scores for these 4 years should be added up. Then each individual bank's total score is added up giving a country CG score. The country CG score is divided by the total number of qualifying statements (which is 75) for *x* series of annual reports. This means that if there are three banks in the country and each bank

has 4-year series of annual reports then the denominator will be 75 multiplied by 3[41] and then by 4[42] which results in the denominator being 900.

The mean Country CG Index is derived by adding up the CGI for all the countries divided by the number of countries.

Constructing RM Index

Similar rules apply to the RM Index, which can also be referred to as the Bank RM Index, except that the total number of QS is 60 instead of 75. The RM Index is constructed based on the total scores the bank obtains in its D9 through D15 dimensions against the total QS in dimensions D9 through D15, which totals to 60, taking into account the number of annual reports for the sampled years.

The RM index is constructed for each bank, which can be referred to as the 'Bank RM Index'. The mean Bank RM Index is derived by adding up the RMI for all the banks divided by the number of banks, which is also constructed for each country, referred to as Country RM Index.

Similar constructs apply to the RM Country Index except that the total QS is 60 instead of 75. The Country RM Index is constructed based on the total scores each individual bank obtains in dimensions D9 through D15, taking into account the number of years, where if the bank has a 4-year series of annual reports then all the scores for these 4 years should be added up. This construct applies to each individual bank in the country where each individual bank's total score is added up to give a country RM score. The country RM score is divided by the total QS (which is 60) for *x* series of years. This means that if there are 3 banks in the country and each bank has a 4-year series of annual reports then the denominator will be 60 multiplied by 3 (*i.e.* banks) and 4 (*i.e.* years) which results in the denominator being 720 (CGI and RMI for each bank and country are shown in Appendix 5.2 Bank). The mean Country RM Index is derived by adding up the RMI for all the countries divided by the number of countries.

[41] Because in the example, three banks are used.
[42] Because in the example, four years of annual reports are used.

The sample mean disclosure (x) for each dimension is derived by summing up the index of each individual bank (I) divided by the sample size (N) which is 53. This can be simplified as,

$$Mean\ (x) = \frac{\sum I}{N}$$

where;

Index = I; and N= Number of banks.

Scale of Disclosure

The examination of annual reports, which is based on 15 dimensions compounded by the 9 underlying themes, is done thematically. The findings of CG disclosure will be discussed based on dimensions represented by D1 through D8, and for RM, the dimensions are represented by D9 through D15. The findings on RM disclosure are set forth in section 5.4.

Each index is categorised based on a scale from 1 to 0 (1 being the highest disclosure and 0 for otherwise). The scoring method is in line with a study done by (Hasan, 2011) who develops a scoring method based on under-developed, emerging, improved, good, and best practices governance in which he emphasises on Shari'ah governance in particular. This should be considered as part of the emerging research by expanding the practice of research. The classification for each disclosure index is as follows:

0.90 <= very high <= 1.0;

0.70 <= high < 0.90;

0.60 <= moderate < 0.70;

0.50 <= low < 0.60 and;

0 <= very low < 0.50.

5.3. FINDINGS ON DISCLOSURE ON CORPORATE GOVERNANCE PRACTICES

This section presents the disclosure analysis results for CG, initially, through dimensions. The results for each dimension are presented at bank level and country level. It should be noted that the details of the index constructs can be found in Chapter 4, the Research Methodology chapter.

5.3.1. Findings on Disclosure on 'Mission' Dimension

This section presents the disclosure results for 'mission' dimension first at the bank level and then at country level.

Bank Level

The findings for the bank level disclosure on 'mission' dimension are depicted in Table 5.1. With the mean being 'moderate*'* at 0.60, it can be deduced that most IBs to a certain extent, have awareness on corporate governance and have accepted that corporate governance codes can establish the bank's direction as reflected in their mission statements. The *'moderate'* score is mostly triggered by the following constructs: the banks' vision towards addressing corporate governance codes, an assessment on the banks' current compliance, and effective communication with their shareholders.

Based on Table 5.1, 23% of the IBs scores were *'very high'*, in between 1 to 0.9 in their mission disclosure indexes. Al-Baraka Turk, Gatehouse, and JIB are among those which scored 100%.

Table 5.1: Disclosure Results on 'Mission' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
AlBaraka	1.00	RHB	0.93	Islami Bank Bangladesh	0.86	Eskan	0.64	Jadwa	0.29	DIB	0.14
Gatehouse	1.00	Ithmaar	0.93	Al-Falah	0.86	Al-Arafah	0.64	QIIB	0.29	Emirates IB	0.14
JIB	1.00	AlInma	0.90	Meezan	0.86	ABCIB	0.61	Capinnova	0.29	Tadamon	0.14
JDIB	1.00	EIIB	0.86	AlJazira	0.79	AlRajhi	0.57	Kuveyt Turk	0.25	Al-Shamal	0.14
CIMB	1.00	BIMB	0.86	BISB	0.79	Bujr	0.57	IIAB	0.21	AlBaraka (Sud)	0.14
ABIB (Bah.)	1.00	HLIB	0.86	Khaleeji	0.79	BLME	0.50	Boubyan	0.18	Faisal (Sud)	0.14
KFH (Bah.)	1.00	BNI Syariah	0.86	Muamalat	0.75	IBQ	0.50	IBB	0.14	Faisal (Egy)	0.00
ADIB (Abu Dhabi IB)	1.00	As-Salam	0.86	QIB	0.71	Shah Jalal	0.50	BSM (Bank Shariah Mandiri)	0.14	AlBaraka (Egy)	0.00
Asya	0.93	Hilal	0.86	Affin	0.71	Rayan	0.43	Kuwait Int.	0.14		

Mean = 0.60

As for the rest of the sampled IBs, 28% of them classified as *'high'*, 6% of them as *'moderate'*, 9% of them as *'low'* mission disclosures. Banks under these three groups (for instance EIIB, Al Rajhi and BLME) do not differ much in terms of the nature of their disclosure. They fall into different ranking because of slight difference in their levels *(i.e.* number) of disclosure. So far, no obvious pattern in the sense of a particular construct can be seen representing any particular group. In general, information in the following constructs: 'assessment with respect to compliance with CG principles' and 'communication with the shareholders' are absent in most of the banks in these groups.

The results imply that the banks have CG awareness as it is observed that there is a trend on IBs adopting the 'mission dimension' of CG and that their objectives are communicated to the public through their 'mission' statements. It seems that the banks have accepted that CG principles can provide substance to the overall conduct of the banks, and hence they provide evidence that CG is incorporated into the mission and vision statement of the banks.

It should, however, be stated that the remaining 34% of the sampled IBs have *'very low'* disclosure in the mission dimension. This could be explained by various reasons. For instance, the banks were newly established during the year the sample was

chosen; Capinnova, Jadwa, and Rayan for example had just commenced their Islamic banking operations after the year 2006. This probably explains why their corporate governance missions have not been fully implemented yet. However, for Kuveyt Turk, QIIB, DIB, Kuwait Int., the absence of corporate governance in their mission statements could be due to lack of awareness on corporate governance as well as persistent gaps in enforcement towards the code itself.

Country Level

The country level results for 'mission' dimension can be found in Table 5.2. With a mean disclosure index of 0.51, this is not quite unexpected as 40% of the IBs are in the 'very low' group (scores in the range of 0.49 to 0). Only 33% of the countries have 'high' scores in their mission disclosure index. For Malaysia, Jordan, Bahrain and Turkey, their respective scores are in the region of 0.88 and 0.76. These could be attributed to the role played by the individual governments that promote CG to portray the country's image as a safe and conducive investment environment through their shared values and goals.

Table 5.2: Disclosure Results on 'Mission' Dimension at Country Level

Country	Mission	Country	Mission	Country	Mission
Malaysia	0.880	Bangladesh	0.629	UAE	0.451
Jordan	0.804	Saudi	0.619	Kuwait	0.163
Bahrain	0.766	UK	0.571	Yemen	0.143
Pakistan	0.762	Indonesia	0.558	Sudan	0.143
Turkey	0.726	Qatar	0.495	Egypt	0.000

Mean=0.51

On the other hand, except for UK, the remaining 67% of the countries where the sampled banks were drawn indicate that they have not fully adopted corporate governance yet. The UK, however, could have achieved a better disclosure index if they were not quite affected by the *'very low'* disclosure score of IBB. Bangladesh, nonetheless, demonstrates 'high' disclosure for the year 2011 only, but this is insufficient to push the country disclosure index to the next level. This could partly be due to the limitations in the sampled banks' annual reports.

As for the findings on Kuwait, it seems that corporate governance awareness has not been rooted. It is understandably difficult for them to gauge how much substance CG

can contribute towards achieving the banks' mission. This may imply that acceptance on corporate governance has not been instigated. For Sudan, despite being in the IB industry for about 30 years, its 'very low' mission disclosure could be due to the fact that the banks are still weak in terms of their institutional base and CG is perceived as too big a concept at this juncture.

5.3.2. Findings on Disclosures for 'Board Composition' Dimension

Bank Level

As can be seen in Table 5.3, with a mean disclosure index of 0.44 for the 'board composition' dimension, this may imply that the independence of the directors is at stake. The results show that only 3 IBs have 'very high' disclosure on board composition; JDIB, BIMB and CIMB are in the 'very high' disclosure group implying that they scored a full disclosure index.

Table 5.3: Disclosure Results on 'Board Composition' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
JDIB	1.00	BNI Syariah	0.78	BLME	0.61	Alinma	0.41	Shah Jalal	0.22	DIB	0.00
BIMB	1.00	ABIB (Bah.)	0.78	AlJazira	0.61	IIAB	0.39	Meezan	0.22	Emirates IB	0.00
CIMB	1.00	Ithmaar	0.75	BISB	0.61	BSM (Bank Shariah Mandiri)	0.39	Al-Arafah	0.11	Tadamon	0.00
JIB	0.92	Affin	0.74	Eskan	0.61	Kuveyt Turk	0.33	Rayan	0.08	Al-Shamal	0.00
RHB	0.92	Muamalat	0.69	Capinnova	0.59	AlRajhi	0.33	QIIB	0.07	AlBaraka (Sud)	0.00
Al Salam	0.92	Hilal	0.67	KFH (Bah.)	0.56	Al-Falah	0.28	IBB	0.06	Faisal (Sud)	0.00
EIIB	0.89	Islami Bank Bangladesh	0.67	ABCIB	0.50	Jadwa	0.25	IBQ	0.00	Faisal (Egy)	0.00
HLIB	0.89	Khaleeji	0.64	ADIB (Abu Dhabi IB)	0.48	QIB	0.25	Boubyan	0.00	AlBaraka (Egy)	0.00
Gatehouse	0.83	AlBaraka	0.61	Asya	0.42	Bujr	0.25	Kuwait Int.	0.00		

Mean = 0.44

It is observed that, in general, the 'high' disclosure in board composition highlights three points: first, the banks have very qualified people who sit on the board; second, the banks have a very highly selective criteria with regards to board appointments; and third, the banks might be more transparent in the decision making process when there are appropriate numbers of the independent and non-executive directors sitting in the board (which might lead to less conflicts of interest).

Based on the above, this implies that the banks in the 'high' disclosure group normally use disclosure as a way to portray their banks' credentials through their boards' credibility based on their affluent academic qualifications and experiences. This could probably explain why JDIB, BIMB, Al Salam, and other banks in the 'very high' and 'high' disclosure group perform well in this dimension. A total of 5 IBs have 'high' scores (in the range of 0.72 and 0.89), which imply that they have established some form of benchmark to guide them on board appointment matters.

Based on observation, almost all banks do not disclose constructs on board monitoring, apart from the banks in the 'very high' disclosure group. It is noted that a number of 27 IBs (the combinations of the 'low' and 'very low' disclosure groups) can be further classified into: the group that does not generally disclose board profiles, such as the qualifications or experience; the group that does not generally disclose the board composition such as, independent or non-executive status; and the group with a total absence of any constructs in this dimension.

The group that does not generally disclose board profiles is represented by ADIB, Al Inma, Jadwa, Al Rajhi, Dawood, Meezan, Al Falah, and Rayan, among others. This may imply that IBs in this group may not have many choices in terms of qualified persons to allow them to be particularly selective in electing board members. That being the case, the IBs may have probably considered using board composition as an effective tool to steer the IBs. There may also be cases associated with bank ownership when the board's credentials and board composition criteria are relegated and not factored into the board appointment process.

It should be noted that Asya, Kuveyt Turk, and Shah Jalal are among the IBs that fall in the group that generally do not disclose board composition. Information on the board qualifications or experience is revealed but disclosure on the board monitoring and assessment is absent. In the case of Kuveyt Turk, this could be due to bank policy where being a private financial institution means that it is governed by the institutional country act (*i.e.* banking act) on information disclosure.

The 'very low' disclosure group is represented by IBQ, Boubyan, Kuwait Int., DIB, Emirates, Tadamon and Al Shamal to name a few. These IBs do not provide any disclosure on board matters. ADIB for instance, does not have disclosure on the board

profiles and composition. In addition, Al Inma does not have constructs on the board profile and most of the banks in this group do not have disclosure on the board performance monitoring which reflects that they may not have CG awareness. Thus, that being the case, the disclosure may only come at a later stage.

Country Level

The country level findings for the 'board composition' dimension can be found in Table 5.4. With a mean of 0.35, which is considered 'very low', it can be deduced that most countries do not have proper guidelines for the 'board composition' dimension. As can be seen, Malaysia ranks top, with a score of 0.92 for the disclosure for its board composition dimension. This could mainly be attributed to regulatory intervention as reflected in the presence of regular board monitoring and assessment practices.

Table 5.4: Disclosure Results on 'Board Composition' Dimension at Country Level

Country	Board Composition	Country	Board Composition	Country	Board Composition
Malaysia	0.918	Turkey	0.454	Qatar	0.104
Jordan	0.806	Saudi	0.400	Kuwait	0.000
Bahrain	0.657	Bangladesh	0.267	Yemen	0.000
Indonesia	0.606	Pakistan	0.250	Sudan	0.000
UK	0.563	UAE	0.214	Egypt	0.000

Mean = 0.35

As the results in Table 5.4 shows, Jordan attains a 'high' score in this dimension, mainly attributed to their disclosure in the boards' profiling and performance monitoring while Bahrain and Indonesia show some improvement, especially on the board monitoring assessment and board profiling towards the later years of the 2000s.

It should be noted that Turkey, Saudi Arabia, Bangladesh, Pakistan, UAE, Qatar, Kuwait and Sudan have yet to develop disclosure practices in this dimension, as reflected by the low disclosure on board information, board composition, and board assessment practices in most of their constructs. Perhaps this is caused by the absence of a regulatory framework with regards to the boards' appointments. In the case of Saudi Arabia, having a family-run business structure and having some private

financial institutions respectively, the banks' board assessment exercise may presumably only occur at the discretion of the shareholders.

5.3.3. Findings on Disclosure on 'Board Leadership' Dimension

Bank Level

As can be seen in Table 5.5, the mean disclosure index of 0.45 reflects a 'very low' achievement by the board in terms of the governing of IBs. The results show that 26% and 6% of the IBs are in the 'very high' and 'high' groups respectively with their scores ranging in between 1 and 0.75. A total of 14 IBs are in the 'very high' group, 12 of which have full disclosure index. This includes EIIB, JIB, IIAB, JDIB and BIMB. It is noted that most of these banks have a very clear CG mission. This implies that the 'board leadership' dimension may be triggered by the adoption of CG principles (which some banks mentioned in their mission statements). The boards in these groups possess leadership qualities that reaffirm their capabilities. For instance, they hold other significant positions elsewhere, they have a proper delineation and segregation of roles and responsibilities, and they exercise independent judgement in their work.

Table 5.5: Disclosure Results on 'Board Leadership' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
EIIB	1.00	Al Salam	1.00	BIMB	0.67	Gatehouse	0.33	Rayan	0.08	Al-Falah	0.00
JIB	1.00	Ithmaar	1.00	ABCIB	0.67	Eskan	0.33	Emirates Islamic Bank	0.08	Meezan	0.00
IIAB	1.00	Capinnova	1.00	KFH (Bah.)	0.67	Bujr	0.25	IBB	0.00	Tadamon	0.00
JDIB	1.00	AlBaraka	0.92	ADIB (Abu Dhabi IB)	0.67	Hilal	0.17	AlRajhi	0.00	Al-Shamal	0.00
BIMB	1.00	Asya	0.92	BLME	0.50	Shah Jalal	0.17	IBQ	0.00	Albaraka (Sud.)	0.00
CIMB	1.00	Affin	0.89	Khaleeji	0.50	Al-Arafah	0.17	Boubyan	0.00	Faisal (Sud.)	0.00
HLIB	1.00	RHB	0.83	AlJazira	0.42	Alinma	0.11	Kuwait International	0.00	Faisal (Egy.)	0.00
BNI Syariah	1.00	Muamalat	0.75	QIB	0.42	QIIB	0.11	DIB	0.00	AlBaraka (Egy.)	0.00
ABIB (Bah.)	1.00	BSM (Bank Shariah Mandiri)	0.67	Kuveyt Turk	0.33	Jadwa	0.08	Islami Bank Bangladesh	0.00		

Mean = 0.45

As the results in Table 5.5 shows, the 'moderate' and 'low' groups account for 9% and 4% of the IBs with scores between 0.67 and 0.50. Apparently, these banks have

quite ‘high’ disclosures but somehow the disclosure index is affected due to an absence of constructs in the independent judgement construct. However, in the case of Muamalat and Khaleeji for instance, disclosure on how the board exercises independent judgement may not necessarily apply to them as the banks’ shares are mainly held by private entities. As such, disclosure may be subjective and at the discretion of the banks (based on the ownership structure). Indices are also affected by the fact that the banks began their operations only after the mid-2000s. In the case of BLME, for instance, full disclosure in this dimension only occurs later in the year since the bank had just commenced its operations in 2007.

The results also show that 55% of the banks are classified as having ‘very low’ disclosure with scores in the region of 0.4 and 0. For example, QIB, Kuveyt Turk and Gatehouse are among the IBs that do not practice disclosure exercises pertaining to the boards’ roles and responsibilities and they do not indicate the way independent judgement is exercised. However some of them, such as QIB and Al Jazira, present the progress of their CG compliance reports.

It can be argued that most of the IBs in the ’very low’ disclosure group do not have CG awareness; thus disclosure in this dimension probably will not materialise until they are ready to adopt its principles. However, in the case of Shah Jalal Bank, its low disclosure on the board’s independent judgement construct could also be attributed to the banks’ ownership structure which is comprised of very high privately-owned shareholding stakes.

Country Level

In terms of country level, the mean disclosure score of 0.36 reflects that board leadership is still ‘very low’ in most countries. Jordan, however, ranks top, followed by Malaysia where both are in the ‘very high’ disclosure category. Indonesia, Bahrain, and Turkey’s scores have relatively ‘high’ disclosure; in the range of 0.79 and 0.72. To a certain degree, this reflects the persistent intervention by the government to ensure leadership competencies among the board, especially with regards to their conduct in ensuring the banks’ performances, such as in the case of Jordan and Malaysia, which are in the top positions in this dimension. For instance, Jordan made

AAOIFI standards mandatory for the IBs in the country while Malaysia imposed IFSB rules on Malaysian IBs.

As can be seen in Table 5.6, 64% of countries fall in the 'very low' category for disclosure, with the scores ranging in between 0.48 to 0. Qatar and Kuwait for instance, seemed to need coherent initiatives from their individual governments to improve on the regulatory guidelines, which will at least ensure an appropriate delegation of the boards' roles and responsibilities and disclosure on independent judgement and their roles and responsibilities.

Table 5.6: Disclosure Results on 'Board Leadership' Dimension at Country Level

Country	Board Leadership	Country	Board Leadership	Country	Board Leadership
Jordan	1.000	UK	0.476	Pakistan	0.083
Malaysia	0.947	UAE	0.205	Kuwait	0.000
Indonesia	0.788	Saudi	0.156	Yemen	0.000
Bahrain	0.737	Qatar	0.156	Sudan	0.000
Turkey	0.722	Bangladesh	0.133	Egypt	0.000

Mean = 0.36

In the case of the UK, the 'very low' disclosure can only be the attributed to the UK's regulatory requirements that require IBs to comply with the FSA. As for Bangladesh, the low index is attributed to the small sample size, despite the existence of the government's commitment to achieve competitiveness. Pakistan may also need to strengthen its reporting, especially towards disclosing more pertinent information with regards to how the boards delegate their roles and responsibilities. This implies that some government directives are required to streamline the reporting as some banks have already shown progress in their communications via their annual reports.

5.3.4. Findings on Disclosure on 'Board Meeting' Dimension

Bank Level

The results in Table 5.7 shows that the mean for the board meeting dimension is reasonably high, at 0.52%, reflecting quite a good disclosure on board meeting attendance. As can be seen, 30% of the IBs have 'very high' disclosure on board meetings. A total of 16 out of 53 banks score full disclosure indexes in the meeting dimension. These include EIIB, Al Rajhi, Al Inma, JDIB, and CIMB. The 'high'

disclosure reflects that the group has a strong commitment for board meetings, and, as such, the details of each meeting in terms of their frequency and attendance are recorded. This implies that this is the banks' strategy to show its accountability by demonstrating a strong sense of commitment from the board members through disclosure on the meeting dimension.

Table 5.7: Disclosure Results on 'Board Meeting' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
EIIB	1.00	ABIB (Bah.)	1.00	AlJazira	0.75	Ithmaar	0.50	Eskan	0.25	Boubyan	0.00
AlRajhi	1.00	ADIB (Abu Dhabi IB)	1.00	BIMB	0.75	Shah Jalal	0.50	ABCIB	0.25	Kuwait International	0.00
Alinma	1.00	Islami Bank Bangladesh	1.00	Muamalat	0.75	Al-Shamal	0.50	Kuveyt Turk	0.13	Dubai Islamic	0.00
JDIB	1.00	Al-Arafah	1.00	JIB	0.63	Faisal (Sud.)	0.50	Gatehouse	0.00	Hilal	0.00
CIMB	1.00	Al-Falah	1.00	BISB	0.63	AlBaraka (Egy.)	0.50	IBB	0.00	Emirates Islamic Bank	0.00
RHB	1.00	Meezan	1.00	AlSalam	0.63	QIB	0.38	Jadwa	0.00	Tadamon	0.00
Affin	1.00	Bujr	1.00	Khaleeji	0.63	Rayan	0.38	QIIB	0.00	AlBaraka (Sud.)	0.00
HLIB	1.00	AlBaraka	0.75	Asya	0.50	Capinnova	0.33	BSM (Bank Shariah Mandiri)	0.00	Faisal (Egy)	0.00
BNI Syariah	1.00	BLME	0.75	IIAB	0.50	IBQ	0.25	KFH (Bah.)	0.00		

Mean = 0.52

As the results in Table 5.7 show, 9%, 8%, and 13% of the IBs are classified as 'high', 'moderate', and 'low' respectively. In most cases, the difference in the bank classification among these groups is mainly triggered by inconsistent absences of constructs in the meeting dimension in some of the reviewed years.

The remaining 40% of IBs are classified as 'very low' disclosure for the 'board meeting dimension', in which the group is comprised of 14 banks with 0 index disclosure scores. Kuveyt Turk, Gatehouse, IBB, and Jadwa are among the banks that do not demonstrate any disclosure on meetings. The reason may simply be that the committee meetings are held whenever deemed necessary, as is the case for Kuveyt Turk, or there is an absence of the terms of reference[43] (TOR) of the board meetings, such as for IBs like Gatehouse, IBB, and Jadwa.

[43] Which sets out formal details such as: frequency and quorum, responsibilities and accountabilities.

Country Level

The results for country-wise comparison of the disclosure index for 'board meeting' dimension can be seen in Table 5.8, which indicates a mean of 0.47% for the board meeting dimension. This, to a certain extent, shows a certain level of commitment by the board. As the results show, Pakistan and Malaysia have a 'very high' disclosure on the meeting dimension. This could be attributed to the existence of board meeting guidelines being put in place. In Malaysia's case, it is part of the regulatory requirements that require details of the board meeting to be recorded to ensure the legality of the decisions made, taking into consideration the quorum and the frequency of the meetings.

Table 5.8: Disclosure Results on 'Board Meeting' Dimension at Country Level

Country	Meeting	Country	Meeting	Country	Meeting
Pakistan	1.000	Indonesia	0.545	Qatar	0.267
Malaysia	0.947	UK	0.500	Egypt	0.250
Bangladesh	0.800	Turkey	0.458	UAE	0.231
Jordan	0.688	Bahrain	0.439	Kuwait	0.000
Saudi	0.667	Sudan	0.318	Yemen	0.000

Mean = 0.47

As can be seen, the 'very low' disclosure in the meeting dimension may imply that some countries such as Kuwait, UAE, Sudan, and Qatar are too lax in terms of handling board meetings, and this could be due to the absence of a TOR in managing the meetings. For countries that have no CG awareness or have not adopted CG, the disclosure in details of the board meetings may not be perceived as significant.

As mentioned above, there may be instances where an absence of disclosure on board meetings is partly due to the fact that the meetings in some banks are held when the need arises, such as in Turkey. Again, for Kuwait, the absence of disclosure on board meetings is probably due to a lack of CG awareness.

5.3.5. Findings on Disclosure on 'Nomination and/or Remuneration Committee' (NR Committee) Dimensions

Bank Level

The mean disclosure index in Table 5.9 of 0.33 on the 'Nomination and/or Remuneration Committee' dimension reflects that the committee is generally not quite established among many IBs. As shown, only 15% (8) of the IBs show 'very high' scores in this dimension, and this includes EIIB, JDIB, and BIMB. This may imply that the existence of an appropriate structure is in place as reflected in the formations of the compensation and remuneration committees. It is also observed that the disclosure level in this dimension is in tandem with the one in the board composition dimension, which implies that, structure wise, the banks are appropriately set up.

Table 5.9: Disclosure Results on 'NR Committee' Dimensions at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
EIIB	1.00	Affin	0.76	ABCIB	0.45	JADWA	0.14	Meezan	0.02	Shah Jalal	0.00
JIB	1.00	BLME	0.75	ADIB (Abu Dhabi IB)	0.45	Kuveyt Turk	0.11	Asya	0.00	Islami Bank Bangladesh	0.00
JDIB	1.00	BNI Syariah	0.67	Eskan	0.43	BSM (Bank Shariah Mandiri)	0.11	IBB	0.00	Al-Arafah	0.00
BIMB	1.00	Muamalat	0.59	As-Salam	0.32	Faisal (Sud)	0.09	QIIB	0.00	Al-Falah	0.00
CIMB	1.00	Alinma	0.52	Gatehouse	0.23	AlBaraka (Egy.)	0.09	IIAB	0.00	Tadamon	0.00
RHB	1.00	AlJazira	0.50	QIB	0.23	IBQ	0.07	KFH (Bah.)	0.00	Al-Shamal	0.00
HLIB	1.00	BISB	0.50	Khaleeji	0.23	Bujr	0.07	Boubyan	0.00	Albaraka (Sud.)	0.00
ABIB (Bah.)	0.95	Ithmaar	0.50	Capinnova	0.21	Hilal	0.05	Dubai Islamic	0.00	Faisal (Egy.)	0.00
AlBaraka	0.82	AlRajhi	0.45	Rayan	0.18	Kuwait International	0.03	Emirates IB	0.00		

Mean = 0.33

The other 6%, 2%, and 9% of the IBs are classified in the 'high', 'moderate', and 'low' disclosure groups respectively. It is noted that BNI Shariah and Muamalat do not disclose the boards' compensation policies. As for Al Inma, Al Jazira, and Al Rajhi, these banks do not have disclosure especially in the board profiles, such as the boards' qualification. This could partly be attributed to the policies spelt out by the respective IBs.

The ‘very low’ disclosure group accounts for 68% of the sampled IBs with their disclosure score in the range of 0 to 0.30. Asya, IBB, and KFH Bahrain are among the 16 IBs with 0 scores. Similar to those banks in the ‘low’ disclosure group, all banks in this group do not have constructs on NR committees.

It is important to note that the classification of ‘low’ or ‘very low’ might be quite misleading, as sometimes IBs, for example Boubyan and Kuwait International, use other committees such as CG or executive committees to take charge of remuneration and nomination matters. Hence, the absence of disclosure on NR committees does not necessarily imply the absence of such committees that take care of remuneration matters.

Country Level

The mean for the ‘nomination and/or remuneration committee’ dimension at Table 5.10 is low, at 0.27%, indicating the low presence of this committee in many countries. As can be seen, Malaysia and Jordan rank as the top two in this dimension with index disclosures at 0.96 and 0.75 respectively. This could partly be attributed to strong government intervention in supporting the banks to strategically promote the recruitment, motivation, and retention of skilled personnel.

Table 5.10: Disclosure Results on ‘NR Committee’ Dimension at Country Level

Country	Nom./Remu Committee	Country	N/R Committee	Country	N/R Committee
Malaysia	0.962	Bahrain	0.372	Pakistan	0.030
Jordan	0.750	Turkey	0.311	Sudan	0.025
UK	0.532	Qatar	0.127	Kuwait	0.013
Indonesia	0.438	UAE	0.112	Bangladesh	0.000
Saudi	0.394	Egypt	0.045	Yemen	0.000

Mean = 0.27

Despite the existence of long-established policies and guidelines, the UK’s incredibly low ranking in this dimension is quite misleading. Based on observations, the low disclosure in this dimension is affected by the absence of disclosure by IBB which outweighs the ‘high’ scores of other IBs in the country.

On the other hand, Qatar, UAE, Kuwait, Pakistan, Bangladesh, and Sudan, to name a few, have ‘very low’ disclosure indexes. Most of the constructs in this dimension do

not disclose the profile of the board and its composition. This could partly be due to the absence of such requirements from the individual governments or non-standard and very minimal reporting requirements for the annual reports.

5.3.6. Findings on Disclosure on '*Shari'ah* Governance' Dimension

Being a specific requirement for IBs, *Shari'ah* governance is essential to ensure that the operations of the products of IBs are in line with Islamic law and ethics. The results presented in this section should therefore be considered within this framework.

Bank Level

As the findings in Table 5.11 show, at 0.31%, the mean disclosure in the 'Shari'ah governance' dimension raises concerns in terms of *Shari'ah* compliancy and governance requirements.

Table 5.11: Disclosure Results on '*Shari'ah* Governance' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
KFH (Bah.)	1.00	CIMB	0.54	Faisal (Sud)	0.42	ABCIB	0.23	Shah Jalal	0.17	Tadamon	0.08
JIB	0.75	Muamalat	0.54	BLME	0.33	Jadwa	0.21	Al-Shamal	0.17	Faisal (Egy)	0.08
JDIB	0.67	Affin	0.53	QIB	0.33	QIIB	0.19	AlBaraka (Sud)	0.17	Al-Arafah	0.04
BIMB	0.67	Meezan	0.52	ADIB (Abu Dhabi IB)	0.33	AlJazira	0.19	Alinma	0.14	Asya	0.00
BNI Syariah	0.67	As-Salam	0.50	Islami Bank Bangladesh	0.33	Bujr	0.19	IIAB	0.13	Kuveyt Turk	0.00
BISB	0.65	RHB	0.42	AlBaraka (Egy)	0.33	EIIB	0.17	IBB	0.10	IBQ	0.00
Gatehouse	0.58	BSM (Bank Shariah Mandiri)	0.42	ABIB (Bah.)	0.25	Kuwait International	0.17	Rayan	0.10	Eskan	0.00
HLIB	0.58	Khaleeji	0.42	Ithmaar	0.25	Dubai Islamic	0.17	AlBaraka	0.08	Al-Falah	0.00
HILAL	0.58	Capinnova	0.42	AlRajhi	0.23	Emirates Islamic Bank	0.17	Boubyan	0.08		

Mean = 0.31

As can be seen, most IBs score 'very low' in terms of disclosure on '*Shari'ah*' governance despite the fact that disclosure reflects the IB's transparency, which is highly expected in dealing with *Shari'ah* matters. Table 5.11 shows that KFH (Bahrain) attains a full score in this dimension index, where it ranked top in '*Shari'ah* governance' disclosure. This affirms KFH (Bahrain)'s position as the market leader in

the Islamic banking industry due to its strict conduct in adherence to '*Shari'ah* compliance'. It should be noted that KFH (Bahrain) is the only IB in the 'very high' disclosure group with a full score, while JIB is the only IB in the 'high' disclosure group, which demonstrates a 'high' index with 0.75.

As shown in Table 5.11, 23 (12%) IBs are classified as 'moderate' and 'low' disclosure group. It is important to note that almost all IBs do not have constructs on policies or procedures on both the *Shari'ah* board appointment as well as the *Shari'ah* board dismissal. Similarly, most of the IBs do not demonstrate clear reporting of *Shari'ah* supervisory structure except for JIB, JDIB and BISB which have demonstrated exceptionally clear reporting lines for the *Shari'ah* supervisory board. Meezan, despite it being in the 'low' disclosure index, has clear procedures on the *Shari'ah* supervisory structure.

In general, most of the banks in these two groups disclose constructs especially in: Shari'ah conformity, Shari'ah board size, and the qualifications and experiences of its board members. Among the banks, JIB, JDIB and BIMB are no exceptions. However, almost all IBs in these two groups do not have constructs on: how Shari'ah board facilitates independent judgements; the number of Shari'ah board meetings, and records of the board members' attendance in the board meetings. It is observed that BISB scores 'highly' in this dimension but only towards the later years *i.e.* in 2010 and 2011. This could probably due to the fact that the banks have just adopted CG principles in 2009.

Based on the Table 5.11, 74% of the IBs fall in the 'very low' category, and this includes RHB, BSM, Khaleeji, and Capinnova. In addition to the above mentioned contributing factors for non-disclosure in the 'moderate' and 'low' groups, the low index for the 'low' group is mainly contributed by the absence of constructs on: the profiling of Shari'ah board members and the board's assigned roles and responsibilities outside the banks. Islami Bank for instance, does not disclose the qualifications and experiences of the board. The absence of such constructs on the board's roles and responsibilities outside the organisation may imply that the *Shari'ah* board also have other external commitments, which may trigger a conflict of interest. It is interesting to note that despite their 'very low' disclosure index, QIB shows a

clear *Shari'ah* board structure in its organisational structure while Al Rajhi demonstrates clear procedures pertaining to the *Shari'ah* supervisory structure.

Country Level

The country level results for Shari'ah governance are shown in Table 5.12. At 0.27%, the mean disclosure index for the *Shari'ah* Governance dimension is 'very low'. As can be seen, no countries show '*very high'* disclosure in their *Shari'ah* governance, which may imply that no countries have disclosure on guidelines on appointment or dismissal of their *Shari'ah* board.

Jordan, Malaysia, and Indonesia, the top three in this disclosure category are barely able to push themselves into the 'moderate' disclosure group, as their scores were relatively 'low' in the region of 0.53 and 0.57. For Jordan, its score could have been lower if it was not because of the newcomer, JDIB, which demonstrated 'high' disclosure in the following year after it commenced its IB operations. As for the Malaysian sample, it revealed no disclosure on *Shari'ah* boards being independent or on having non-executive members. The fact that most *Shari'ah* boards are appointed by the banks gives the impression that they are not independent, more so when they hold executive positions in the bank. On another note, most of the Malaysian sample shows no constructs on the details and attendance of the members with regards to *Shari'ah* board meeting; this is quite intriguing as it begs the question as to whether they are fully engaged with the banks' business.

Table 5.12: Disclosure Results on '*Shari'ah* Governance' Dimension at Country Level

Country	Sharia Governance	Country	Sharia Governance	Country	Sharia Governance
Jordan	0.573	UK	0.256	Qatar	0.156
Malaysia	0.548	Pakistan	0.236	Bangladesh	0.150
Indonesia	0.530	Sudan	0.235	Kuwait	0.119
Bahrain	0.422	Egypt	0.208	Yemen	0.083
UAE	0.269	Saudi	0.194	Turkey	0.028

Mean = 0.27

The remaining 80% (12) of the countries have 'very low' disclosure, mainly due to most of the *Shari'ah* board members information, such as their profiles, roles and responsibilities not being disclosed. This could probably due to the absence of

directives from the government or regulatory bodies to enforce compliance on disclosure. To a certain extent, this may imply the absence of full engagement from the *Shari'ah* Board in the bank's operations. On another note, the boards may have other external commitments outside the banks thus not giving full disclosure may be an easy way to avoid revealing the possibility of conflicts of interest occurring.

5.3.7. Findings on Disclosure on '*Shari'ah* Compliance' Dimension

As part of *Shari'ah* governance, *Shari'ah* compliance is also essential for Islamic banks as it determines whether the operations and products of IBs in accordance with Islamic law and ethics. The results presented in this section identify how *Shari'ah* compliance issues are communicated to the larger stakeholders by the sampled IBs.

Bank Level

The 'very low' mean disclosure index of 0.17% for the '*Shari'ah* Compliance' dimension in Table 5.13 implies that most banks have very poor transparency in *Shari'ah* matters. Similar to the conduct in the *Shari'ah* governance dimension, KFH (Bahrain) once again ranks the top.

Table 5.13: Disclosure Results on *'Shari'ah* Compliance' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
KFH (Bah.)	0.92	Capinnova	0.26	ABCIB	0.15	AlRajhi	0.06	Jadwa	0.03	Boubyan	0.00
BISB	0.86	ADIB (Abu Dhabi IB)	0.26	QIIB	0.15	Islami Bank Bangladesh	0.06	IIAB	0.03	Shah Jalal	0.00
ABIB (Bah.)	0.83	QIB	0.22	EIIB	0.11	Faisal (Egy)	0.06	AlJazira	0.01	Al-Arafah	0.00
BIMB	0.72	Al Salam	0.19	Emirates IB	0.11	Albaraka (Egy)	0.06	AlBaraka	0.00	Al-Falah	0.00
Khaleeji	0.72	Hilal	0.19	RHB	0.08	Rayan	0.04	Asya	0.00	Meezan	0.00
Ithmaar	0.53	Affin	0.19	HLIB	0.08	Bujr	0.04	Kuveyt Turk	0.00	Tadamon	0.00
DIB	0.36	CIMB	0.17	BLME	0.07	Kuwait Int.	0.04	Alinma	0.00	Al-Shamal	0.00
JIB	0.33	BNI Syariah	0.17	Muamalat	0.07	Faisal (Sud)	0.04	BSM (Bank Shariah Mandiri)	0.00	Albaraka (Sud.)	0.00
JDIB	0.33	IBQ	0.15	IBB	0.06	Gatehouse	0.03	Eskan	0.00		

Mean = 0.17

As shown in Table 5.13, KFH (Bahrain) is the only IB with 'very high' disclosure in this dimension. This reflects its openness in releasing information on how businesses

are dealt with, taking *Shari'ah* principles into consideration. KFH (Bahrain) has been clear in disclosing information pertaining to the way the board exercises their judgements in carrying out their responsibilities.As the results in Table 5.13 show, BISB, ABIB, BIMB and Khaleeji score relatively 'high', with indices ranging between 0.86 and 0.72. BISB's disclosure score only picks up in 2010 and 2011 especially in the constructs of: method of zakah calculation, technique and policies on smoothing, and distribution of PER, while Khaleeji shows very encouraging progress in 2009 onwards. Malaysia on the other hand, seems to be very cautious on disclosing information pertaining to investment account holders as well as *zakah*. This may imply that some of the operations could not be fully disclosed without imposing questions that may be too contentious with respect to practices versus *Shari'ah* compliance. There seems to be a debatable grey area which may be seen as sensitive since different countries seem to have various interpretations with regards to *Shari'ah*.

Table 5.13 shows that 47 or 89% of the IBs have 'very low' disclosure in this dimension. Despite being mandated as institutions that uphold Islamic principles, most of them choose not to disclose information on their *Shari'ah* practices. This may imply that they may not fully adopt Islamic practices as they pledge and would rather hide under the Islamic name to gain confidence from the niche market. Long-established Islamic banks such as DIB for instance should be the role models in demonstrating *Shari'ah* compliance traits instead. This dimension should be encouraged through awareness since disclosure is equally important as being transparent as prescribed by Islam. Banks such as JIB, JDIB, and IIAB have 'very low' disclosure possibly due to constraints in the regulatory bodies in overseeing *Shari'ah* matters.

Out of 47 IBs, a number of 14 IBs do not have *Shari'ah* compliance constructs. Quite similar to the Jordanian banks mentioned above, Al BarakaTurk, Asya and Kuveyt Turk also do not communicate any information regarding Shari'ah compliancy disclosure. Similarly, Al Inma and Boubyan are among the banks in this group that have no disclosure in any constructs. This could also imply that for most banks, what they practice is more significant than revealing it as good deeds are all about God's judgement. As such, they may perceive that whatever is performed does not necessarily need to be announced.

Country Level

Similar to bank level analysis, the mean for the '*Shari'ah* compliance' dimension is 'very low', at 0.11% country-wise, as depicted in Table 5.14. As can be seen, no countries show 'very high' disclosure in *Shari'ah* compliance dimension. It is hard to generalise the reasons as to why the countries have very low scores because disclosure on this dimension is quite country-specific in nature. Bahrain, the home of policy and guideline issuers for Islamic banks, is not doing well in this area either, most probably due to banks such as Eskan and ABC Islamic Bank which do not perform well in disclosure on *Shari'ah* compliance.

Table 5.14: Disclosure Results on *'Shari'ah* Compliance' Dimension at Country Level

Country	*Shari'ah* Compliance	Country	*Shari'ah* Compliance	Country	*Shari'ah* Compliance
Bahrain	0.483	UK	0.071	Pakistan	0.014
Jordan	0.257	Indonesia	0.071	Bangladesh	0.011
Malaysia	0.251	Egypt	0.056	Sudan	0.010
UAE	0.235	Saudi	0.026	Turkey	0.000
Qatar	0.141	Kuwait	0.016	Yemen	0.000

Mean: 0.11

Similarly, as can be seen, Jordan has very poor disclosure in most of its IBs. Despite some improvements in IIAB as well as JDIB, which start to pick up after its establishment in 2010, disclosure is still 'very low'. It is perceived that *Shari'ah* non-compliance is ruled out by the regulators, as there is no such body to take care of the matter. The absence of *Shari'ah* regulatory bodies is also reflected by the variations of *Shari'ah* interpretations, especially in the matter of compliance issues. In other words, low disclosure could be due to the absence of specific regulatory bodies that could legislate *Shari'ah* matters.

As for Malaysia, it is observed that the main factor that contributes to its poor disclosure can be explained by the fact that most of the constructs pertaining to investment account holders and profit allocation are not disclosed by most Malaysian banks. Quite contrary to Jordan, despite the existence of the regulatory bodies that deal with *Shari'ah* matters, Malaysia's disclosure is still 'very low'. Perhaps this is

due to the multitude of interpretations from various *Shari'ah* bodies making non-disclosure the safest way to avoid conflicts, as far as IBs are concerned,

It is interesting to note that non-disclosure in the *Shari'ah* theme is anticipated in most countries. The absence of awareness in disclosing *Shari'ah* matters among most of the banks is quite obvious, as reflected by the mean disclosure of 0.17. In most cases, banks do not have information communicated on the constructs such as: how they handle the customers' account, profit calculation, asset allocation, and investment account holders' rights.

Quite differently, IBs in Turkey have to apply specific codes according to their banking act that they have to adhere to, and this may not necessarily reveal the banks as being *Shari'ah*-compliant banks. The non-disclosure on matters pertaining to *Shari'ah* compliance gives the impression that, as far as the regulatory bodies are concerned, they do not have to abide by *Shari'ah* law. This poses some questions such as: "are IBs fully supported by the regulators?" and; "Do these IBs exist to uphold Islamic principles or are they merely to capture a market segment as far as Islamic funds are concerned?".

5.3.8. Findings on Disclosure on 'Ethical Businesses' Dimension

Bank Level

The findings in Table 5.15 for 'ethical business' dimension shows that the mean is 'very low', at 0.21%, reflecting that there are still many banks which do not regard ethics as an important dimension for disclosure. KFH (Bahrain) ranks the top with ABIB being the second best scorer in disclosure on the ethical business index. While Ithmaar, RHB, CIMB and Al Baraka are classified as having 'high' disclosure, others fall short where 40% of the IBs show 'very low' ethics and business practices. Big market players like Al Baraka and CIMB are able to score comparatively higher than most IBs as they may have the adequate resources to do so. This may also be one way of taking care of their reputations. This is reflected in the annual reports. For instance, in the case of CIMB, the bank is described as doing charity programmes, which seem to be socially-responsible in nature.

Table 5.15: Disclosure Results on 'Ethical Businesses' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
KFH (Bah.)	1.00	ABCIB (Arab Banking Corp. Islamic Bank)	0.46	Muamalat	0.25	EIIB	0.08	IBB	0.00	Shah Jalal	0.00
ABIB (Bah.)	0.92	Asya	0.44	IIAB	0.23	Alrajhi	0.08	Jadwa	0.00	Al-Arafah	0.00
Ithmaar	0.73	Gatehouse	0.38	Islamibank Bangladesh	0.23	Abu Dhabi Islamic Bank (ADIB)	0.08	IBQ	0.00	Tadamon	0.00
RHB	0.69	BNI Syariah	0.38	Dawood (Bujr)	0.17	Al-Falah	0.08	QIIB	0.00	Al-Shamal	0.00
CIMB	0.65	Al Salam	0.37	Kuveyt Turk	0.15	Meezan	0.08	JIB	0.00	Albaraka (Sudan)	0.00
Albaraka	0.62	BISB	0.35	Rayan(Mar)	0.12	Aljazira	0.06	Affin	0.00	Faisal (Sudan)	0.00
Khaleeji	0.54	Eskan	0.31	JDIB	0.12	Alinma	0.05	Boubyan	0.00	Faisal (Egypt)	0.00
Hilal	0.54	HLIB	0.27	BSM(Bank Shariah Mandiri)	0.12	Dubai Islamic	0.02	Kuwait International	0.00	Albaraka (Egypt)	0.00
BIMB	0.46	QIB	0.25	Capinnova (Subs.Of BBK)	0.10	BLME	0.00	Emirates Islamic Bank	0.00		

Mean = 0.21

Overall, IBs have yet to disclose their ethical traits in running the operations of the banks as per *Shari'ah* prescription. The mean index of 0.21 for disclosure on ethical business indicates that most of the IBs have very poor commitments in disclosing their ethics value in their business conducts. This may imply that ethics, even in the banking business, is an area that has not fully developed. On another note, it is hard to set the boundary as to what actions are considered ethical. However as far as Islamic principles go, transparency should be the gist of ethics.

Country Level

The disclosure results for 'ethical business' dimension at the country level is depicted in Table 5.16, which shows that at 0.14%, the mean disclosure index for the 'ethical business' dimension is 'very low'. As can be seen, Bahrain ranks the top while other countries are yet to show any indication towards ethics disclosure. This gives the impression that main market players such as Bahrain are trying to set a precedence that demonstrate that business practices should be based on ethical values, which encompass honesty and integrity apart from transparency in conducting their business affairs.

Table 5.16: Disclosure Results on 'Ethical Businesses' Dimension at Country Level

Country	Ethic Conduct	Country	Ethic Conduct	Country	Ethic Conduct
Bahrain	0.520	UAE	0.107	Bangladesh	0.046
Malaysia	0.437	Qatar	0.097	Kuwait	0.000
Turkey	0.404	Jordan	0.087	Yemen	0.000
Indonesia	0.238	UK	0.077	Sudan	0.000
Pakistan	0.109	Saudi	0.046	Egypt	0.000

Mean = 0.14

5.3.9. Overall Results for CGI

After presenting the findings for disclosure index for bank level and country level for each dimension in the preceding sections, this section aims to provide bank and country level overall results.

Bank Level

The overall findings of the CGI for dimensions at bank level are depicted in Table 5.17, which shows that the mean disclosure for overall CGI is 0.25%, which is unjustifiably low considering that CG is the key aspect of the bank's strategic direction which encompasses the overall mission and operations. This is explained somewhat by the fact that CG may have not be widely adopted by IBs, and thus disclosure in relation to its principles may not occur in a short period of time. In addition, the political economies of the countries where Islamic banks operate have not essentialised CG as an important structural matter.

As presented in Table 5.17, 3 IBs have 'high' scores on CGI disclosure. These are ABIB, BIMB and KFH, which score in between 0.79 to 0.74. It may imply the existence of a CG structure being put in place and adhered to by these banks. ABIB and BIMB score very highly under the board theme, while KFH demonstrates very high disclosure under the *Shari'ah* theme.

As can be seen, CIMB, JDIB, and BISB are among the 6 IBs that are classified as having 'moderate' disclosure with a score in the range of 0.66 and 0.60. Despite the 'very high' disclosure under the board theme, CIMB and JDIB's performances in overall CGI are just moderate due to their very poor scores in *Shari'ah* compliance

and ethics respectively. As for BISB, it is consistently moderate in all dimensions and performs comparatively high in *Shari'ah* governance, except for in the audit and ethics dimensions. Ithmaar's performance in disclosure is quite consistent throughout the dimensions except for its relatively low disclosure under *Shari'ah* governance.

Table 5.17: Overall Bank Level Results for all the Dimensions

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
ABIB (Bah.)	0.793	HLIB	0.560	Hilal	0.407	Eskan	0.270	DIB	0.130	Emirates IB	0.070
BIMB	0.767	Khaleeji	0.553	ADIB (Abu Dhabi IB)	0.400	Asya	0.263	Kuveyt Turk	0.123	Kuwait Int.	0.053
KFH (Bah.)	0.740	BNI Syariah	0.551	ABCIB	0.370	AlRajhi	0.250	Jadwa	0.120	Al-Shamal	0.053
CIMB	0.667	As-Salam	0.483	BLME	0.340	Meezan	0.233	Shah Jalal	0.120	IBB	0.050
JDIB	0.633	EIIB	0.467	Capinnova	0.324	Bujr	0.200	Faisal(Sud.)	0.116	AlBaraka (Sud)	0.040
Bahrain Isl.	0.633	AlBaraka	0.463	QIB	0.307	BSM (Bank Shariah Mandiri)	0.190	Al-Arafah	0.113	Boubyan	0.030
RHB	0.610	Affin	0.458	AlJazira	0.300	IIAB	0.187	QIIB	0.107	Tadamon	0.027
JIB	0.607	Muamalat	0.437	Islami Bank Bangladesh	0.293	Al-Falah	0.153	IBQ	0.100	Faisal(Egy)	0.027
Ithmaar	0.597	Gatehouse	0.407	Alinma	0.271	Rayan	0.137	AlBaraka (Egy)	0.093		

Mean = 0.32

HLIB, Khaleeji, and BNI Shari'ah are the 3 IBs that have 'low' disclosure indices. HLIB's performances in disclosure are high and quite consistent throughout the dimensions except for disclosure under the *Shari'ah* theme where they are doing very poor. This is quite similar to Khaleeji. As in the case of BNI *Shari'ah*, its low disclosure results from *Shari'ah* compliance.

Banks from the 'very low' disclosure index group such as EIIB and Al Baraka demonstrate very poor disclosure on *Shari'ah* compliance. This is not unexpected, as EIIB has to adhere to FSA guidelines on top of its compliance list despite being an Islamic institution. Al Baraka Turk on the other hand, does not reveal any disclosure in the *Shari'ah* dimension. Quite interestingly, it is noted that, despite the fact that Al Baraka Turk does not reveal its Islamic practices in view of it being imposed upon by tentative social pressure, this could also imply that observing Islamic practices may

possibly act as a detriment that induces negative perception towards religiosity in Turkish's society, hence evidencing very poor disclosure on *Shari'ah* compliance.

Country Level

Similar to the bank-wise disclosure, having the mean index disclosure for the overall-country index at 0.25% for all the dimensions is very low. As presented in Table 5.18, there are no countries with 'very high' disclosure in CGI dimension. Being in the 'high' disclosure group in the overall CGI, Malaysia's top position is contributed by its high scores especially in board leadership, board composition, and board meeting dimensions. This reflects very high government intervention in the bank's regulations. This could be reflected in the form of strict regulatory framework enforced by the government on board-related matters.

Table 5.18: Overall Country Level Results for all the Dimensions

Country	Overall CGI	Country	Overall CGI	Country	Overall CGI
Malaysia	0.620	Turkey	0.283	Bangladesh	0.152
Bahrain	0.520	Saudi	0.233	Sudan	0.065
Jordan	0.508	UAE	0.216	Egypt	0.060
Indonesia	0.378	Pakistan	0.196	Kuwait	0.040
UK	0.303	Qatar	0.166	Yemen	0.027

Mean: 0.25

The remaining 10 sampled IB countries or 79% of the sampled countries are considered as scoring 'very low' in the overall CGI dimension, the scores ranging between 0.45 and 0.05. The sample shows that the countries' mean CGI disclosure is 0.28, which is quite low despite many discussions in the literature of its significance. The low CG disclosure is mainly affected by 3 dimensions: *Shari'ah* compliance, ethics, and *Shari'ah* governance, all of which demonstrate 'very low' mean scores of 0.12, 0.17 and 0.28, respectively. The 'low' disclosure of these dimensions is mainly contributed to by countries such as Kuwait, Saudi Arabia, and Qatar, apart from Bangladesh and Turkey. This could possibly indicate quite a lax commitment by the governments and the IBs themselves.

Countries such as Indonesia, Turkey, Saudi Arabia, UAE and Pakistan demonstrate 'very low' disclosure in their overall CGIs with the sampled IBs drawn from these countries. In general, the banks do not have strict regulatory guidelines that enforce

them to work towards CG compliance. Saudi Arabia for instance, might not have streamlined directives between the regulators thus an implementation of corporate governance best practices may be hard to achieve. As for the UK, the disclosure level seems to be quite encouraging despite its strong commitment to comply with regulatory bodies such as the FSA first.

5.4. FINDINGS ON DISCLOSURE ON RISK MANAGEMENT PRACTICES

The previous sections focus on the communicated information performance of IBs in CG practices in the bank and country level. This part shifts the focus on the risk management practices of the sampled IBs in measuring their performance in relation to the communicated information in their annual reports on the years identified by developing the results for risk management index or RMI. The results are initially presented at the bank and country level for each of the identified dimensions (see: Research Methodology Chapter for the details).

5.4.1 Findings on Disclosure on 'Risk Management Committee' Dimension

Bank Level

The findings for disclosure on 'risk management committee' dimension can be found in Table 5.19, which shows a relatively 'low' RMI at 0.53, implying that most IBs have average risk management practices in relations to 'risk management committee'. As can be seem, 28% of the IBs have 'very high' disclosure on the RM Committee, while 15 IBs have full disclosure index in this dimension in which Al Baraka, IBB and EIIB are part of them. It is observed that generally most banks in this group appoint board members to be in the risk management committees. Hence risk management oversight is under the purview of the board. It is also noted that the group disclosed the board's full accountability on the overall risk. 'High' disclosure in this dimension implies that banks try to portray that the board takes full accountability on the overall risk.

Table 5.19: Disclosure Results on 'Risk Management Committee' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
AlBaraka	1.00	As-Salam	1.00	BISB	0.79	Bujr	0.58	Kuwait Int.	0.22	Boubyan	0.00
IBB	1.00	KFH (Bah.)	1.00	Gatehouse	0.67	Khaleeji	0.54	Al-Falah	0.17	Shah Jalal	0.00
EIIB	1.00	ADIB (Abu Dhabi IB))	1.00	AlRajhi	0.67	JDIB	0.50	BSM (Bank Shariah Mandiri)	0.08	Islami Bank Bangladesh	0.00
Alinma	1.00	Hilal	1.00	AlJazira	0.67	Eskan	0.50	Al-Arafah	0.08	Al-Shamal	0.00
QIB	1.00	BLME	0.92	QIIB	0.67	IBQ	0.46	Jadwa	0.04	AlBaraka (Sud.)	0.00
BIMB	1.00	Asya	0.83	CIMB	0.67	Muamalat	0.42	Tadamon	0.04	Faisal (Sud.)	0.00
Affin	1.00	Kuveyt Turk	0.83	ABCIB	0.67	DIB	0.38	JIB	0.00	Faisal (Egy)	0.00
HLIB	1.00	RHB	0.83	Emirates IB	0.67	Rayan	0.33	IIAB	0.00	AlBaraka (Egy)	0.00
ABIB (Bah.)	1.00	Capinnova	0.83	Ithmaar	0.58	Meezan	0.33	BNI Syariah	0.00		

Mean = 0.53

As shown in Table 5.19, about 9% and 13% of the IBs are classified as 'high' and 'moderate' disclosing institutions for this dimension, respectively. These include Asya, RHB, Kuveyt Turk, BISB, and Capinnova in the 'high' group, whilst Gatehouse, Al Rajhi, Al Jazira, QIIB, CIMB, ABCIB, and Emirates Islamic are in the 'moderate' group. Generally, there is not much significance in the disclosure pattern between these two groups. Most of them have an absence of information on the following constructs: board providing risk oversight and audit responsibility for risk. As for BISB and QIIB, their indexes are affected by the fact that they just started to pick up after the years 2009 and 2010 respectively.

About 9% and 26% of the sampled IBs are classified in the 'low' and 'very low' risk governance disclosure group; scoring between 0.58 to 0.5 and 0.46 to 0 respectively. For example, Ithmaar, Dawood, Khaleeji, JDIB, and Eskan are grouped as having 'low' disclosure, while Shah Jalal, Islami Bank and Al Shamal are among the banks in the 'very low' disclosure group with indexes of 0. In general, a few banks in the 'low' group for instance, Dawood (Bujr), do not have disclosure on board being responsible for the overall risk. The absence of information communication on this construct may imply the absence of board representatives in the risk management committee or the banks do not have a dedicated board risk management committee.

There might be cases that the risk management function is carried out by other committees such as the executive committee. Boubyan for instance, establishes an executive committee to take care of its risk management. The absence of boards with adequate knowledge and experience in risk management could also contribute to absence of disclosure in this dimension.

Country Level

In the case of country-wise findings for the 'risk management committee' disclosures, the level of risk management in IBs is 'very low', at 0.41. This may reflect that some of the countries do not have adequate structures to support risk management. Based on Table 5.20, the UK ranks top in the risk governance disclosure. The 'high' index, 0.93 is triggered by the 'very high' disclosure in its sample banks (as reflected in IBB and EIIB). This can be explained by the fact of the UK government's intensified intervention and prudent regulation on risk management.

Table 5.20: Disclosure Results on 'Risk Management Committee' Dimension at Country Level

Country	Rmgtcom	Country	Rmgtcom	Country	Rmgtcom
UK	0.929	Qatar	0.611	Kuwait	0.095
Malaysia	0.895	Saudi	0.567	Yemen	0.042
Turkey	0.889	Pakistan	0.361	Bangladesh	0.033
Bahrain	0.753	Indonesia	0.182	Sudan	0.000
UAE	0.705	Jordan	0.125	Egypt	0.000

Mean = 0.41

As can be seen in Table 5.20, Malaysia, Turkey, Bahrain, and UAE demonstrate 'high' disclosure index, mostly contributed to by their government policies and legislative actions. As the home to regulatory bodies such as IFSA, AAOIFI and LMC, Malaysia and Bahrain is in the best position to be able to provide policies and guidelines in managing risks. Thus in principle, disclosure should not be an issue for these countries.

Kuwait and Bangladesh are among the 33% countries that have 'very low' risk management committee disclosure in relation to the sampled IBs, with scores 0.10 and 0.02 respectively. This may imply the absence of board representatives to provide risk management oversight.

5.4.2. Findings on Disclosure on 'Risk Management and Controls' Dimension

Bank Level

Table 5.21 depicts the communicated information on the constructs related to 'risk management and controls' dimensions at bank level. As the results indicate, at 0.70 the mean disclosure on 'risk management and controls' dimension is comparatively 'high', reflecting that most IBs have proper controls on risk management. This implies a relatively high transparency in risk management and controls dimension.

Table 5.21: Disclosure Results on 'Risk Management and Controls' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
AlBaraka	1.00	BIMB	1.00	ADIB (Abu Dhabi IB)	1.00	BISB	0.85	Muamalat	0.53	Faisal (Sud)	0.20
Asya	1.00	CIMB	1.00	Hilal	1.00	Ithmaar	0.85	Kuwait Int.	0.47	Albaraka (Egy)	0.20
Gatehouse	1.00	RHB	1.00	Shah Jalal	1.00	Faisal (Egy)	0.80	Boubyan	0.45	Jadwa	0.13
EIIB	1.00	Affin	1.00	Al-Arafah	1.00	IBB	0.73	Rayan	0.43	Islami Bank Bangladesh	0.10
AlRajhi	1.00	HLIB	1.00	Al-Falah	1.00	Eskan	0.68	IIAB	0.40	BSM (Bank Shariah Mandiri))	0.00
AlJazira	1.00	ABIB (BAH.)	1.00	Kuveyt Turk	0.98	QIIB	0.67	Meezan	0.40	BNI Syariah	0.00
Alinma	1.00	Khaleeji	1.00	BLME	0.98	Capinnova	0.67	Tadamon	0.35	Al-Shamal	0.00
QIB	1.00	ABCIB	1.00	Emirates IB	0.90	As-Salam	0.60	JDIB	0.30	Albaraka (Sud)	0.00
IBQ	1.00	KFH (Bah.)	1.00	Bujr	0.88	DIB	0.58	JIB	0.20		

Mean = 0.70

As shown in Table 5.21, 49% of the IBs have 'very high' disclosure in risk management and controls dimension. As can be seen, Al Baraka, Gatehouse and EIIB, to name a few, are among the 23 IBs that score full indices. This implies that some banks regard risk management and controls as one of the strategies that show strong commitment in managing risks. They disclose relevant risk information in most of the following constructs: the management roles and responsibilities, their risk appetites, and the type of risk measures they have in place. The banks could probably try to increase their credibility through disclosure, because, at the very minimum, disclosure

provides a comfort zone to the investors and stakeholders to gauge the bank's exposure and vulnerabilities.

The remaining 51% of IBs are classified into four groups: 'high', 'moderate', 'low' and 'very low' groups, whose scores range between 0.88 and 0. However, based on observation, IBs across these four groups can be divided further into two sub-groups: banks that are newly established and banks with non-elaborate standard annual reporting. It is interesting to note that apparently these two are the main factors that affect the disclosure index; the disclosure indices of these banks are not poor, but somehow, the indices are low due to the fact that most of these banks are relatively new.

In general, newly established IBs like Boubyan, Eskan, QIIB, Capinnova, Al Salam and Rayan (which began their operations in 2011, 2009, and 2010 respectively) have published annual reports for two years only. As such, their disclosure index is very much affected by the small sample size. As for the other group of banks like Al Shamal, observation through disclosure via annual report is not that helpful as these banks have very minimal annual reporting. The RM could be reasonably 'high' but this has not been elaborated well in the annual reports, which could be due to the absence of standards set to regulate communications and reporting.

It could also be the case that newly-established IBs, such as Kuwait International, JDIB, and Rayan have *'very low'* disclosure in this dimension due to the fact that the risk management structure has not been fully set up and developed, thus full disclosure in this dimension may not take place until the later years of 2000s.

Additionally, a low index could imply that inadequate mandates are given to the management to support the risk management function. Al Salam, for instance, has no disclosure for constructs on: senior management's commitment, risk management framework, risk appetite, and *etc*. DIB on the other hand, may have only developed a RM structure in later years, *i.e.* in 2010 and 2011 despite being in the industry for many years (no disclosure is reflected prior to 2010).

Country Level

As shown in Table 5.22, the sample mean disclosure index of 0.64 is quite 'moderate' for the 'risk management and committee' dimension. Perhaps this is due to initiatives to manage risk being put in place by their respective governments. Based on Table 5.22, Malaysia, Turkey and UK have 'very high' disclosures in the risk management and controls dimension; implying the countries' have good RM set up and that the structure is in place.

Table 5.22: Disclosure Results on 'Risk Management and Controls' Dimension at Country Level

Country	RMgt. Disclosure	Country	RMgt. Disclosure	Country	RMgt. Disclosure
Malaysia	1.000	Bangladesh	0.820	Kuwait	0.457
Turkey	0.992	Qatar	0.780	Yemen	0.350
UK	0.914	Saudi	0.767	Jordan	0.275
Bahrain	0.845	Pakistan	0.758	Indonesia	0.191
UAE	0.838	Egypt	0.500	Sudan	0.055

Mean = 0.64

As much as regulators pose regulatory intervention on how IBs should respond to shocks, maintain liquidity, *etc*., the banks also need to address their capital adequacy, liquidity issues, and *etc*. In the case of Malaysia, IBs are instructed to disclose information on risks to show their readiness with accepting certain levels of risks; for example by providing appropriate and adequate information to show their comfort level to investors.

While 50% of the countries under this dimension are classified as having 'high' disclosure index, countries such as Kuwait, Jordan, Indonesia, and Sudan show 'very low' scores in the risk management dimension. In the case of Kuwait and Jordan, a number of their banks are quite newly-established, thus not much disclosure can be observed in their risk management and control dimension.

5.4.3. Findings on Disclosure on 'Audit' Dimension

Bank Level

As the results in Table 5.23 show, no banks have 'very high' disclosure in the audit dimension. The mean disclosure for audit dimension being 0.3 can be mainly attributed to the 'very low' disclosure scored by more than 80% of the IBs. This strongly implies that the audit dimension is undermined by other dimensions in most IBs operations.

Table 5.23: Disclosure Results on 'Audit' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
CIMB	0.84	IIAB	0.48	BNI Syariah	0.36	Alinma	0.26	Jadwa	0.17	Tadamon	0.05
BIMB	0.69	JDIB	0.48	Hilal	0.36	Shah Jalal	0.25	Al-Arafah	0.16	Al-Shamal	0.05
EIIB	0.68	BLME	0.45	AlRajhi	0.35	Aljazira	0.24	IBB	0.14	AlBaraka (Sud)	0.05
HLIB	0.68	ADIB (Abu Dhabi IB)	0.45	JIB	0.32	KFH (Bah.)	0.24	Faisal (Sud)	0.14	Faisal (Egy)	0.05
RHB	0.64	Ithmaar	0.44	Bujr	0.32	Gatehouse	0.23	Rayan	0.13	IBQ	0.03
ABIB (Bah.)	0.61	Affin	0.44	Meezan	0.31	BISB	0.22	Boubyan	0.11	QIIB	0.03
Asya	0.56	Muamalat	0.43	Eskan	0.28	As-Salam	0.20	Albaraka (Egy)	0.09	BSM (Bank Shariah Mandiri)	0.01
AlBaraka	0.55	Islami Bank Bangladesh	0.41	Kuveyt Turk	0.27	QIB	0.18	DIB	0.07	Kuwait Int.	0.00
ABCIB	0.52	Khaleeji	0.40	Al-Falah	0.27	Capinnova	0.18	Emirates IB	0.05		

Mean = 0.30

As shown in Table 5.23, CIMB attained the highest disclosure, scoring 0.84, which is classified as 'high'. The other 9% and 6% of IBs are classified as 'moderate' and 'low' disclosure, respectively, while the remaining majority of the banks (83%) are classified in the 'very low' disclosure group. Based on observation, it is noted that no single bank discloses constructs on board undertakings, *i.e.* whether they are confident of the independence and integrity of the external auditors.

It should be noted that absence of disclosure is observed in most of the following constructs: the audit committee's profiles and composition, the appointment process, external audit matters, and the terms of reference of audit and its scope of work. However, in general, the audit dimension constructs can be grouped into three main areas: 'board profile-related', 'external audit related', and 'internal audit' related.

Based on observation, there seems to be a pattern that signifies the bank's disclosure level.

IBs in 'high' disclosure groups, such as CIMB, and almost all the banks in the 'moderate' group do not disclose most of the information on external audit-related constructs such as: 'duration of current external audit engagement', 'rotation of audit partners', and 'proportion of audit fees'.

Considering the fact that external auditors are appointed by the bank, this raises questions on the independence of external auditors where the audit assessment itself could be quite subjective. The transparency on how the banks are audited and assessed is quite bleak, especially with regards to external audit engagement and this is reflected in low disclosure. For instance, except for BIMB and EIIB, it is noted that not many banks disclose audit fee charges.

In general, most banks in the 'low' and 'very low' group do not disclose much information especially on board-related constructs. It is observed that the absence of constructs on the status (independent or non-executive) and profiles (qualification and background) of the audit chairman and other members of the audit committee in IBs are quite obvious in most IBs in these groups. Asya and AlBaraka Turk for instance do not have constructs on status and profiles. The non-disclosure on the membership status may imply that there may be a conflict of interest issues, *i.e*. the audit board might hold other roles or is also a member of other committees. As for the absence on the audit committee profile, this gives the impression that audit members may not have the proper skill sets to be in such a committee and hence less disclosure occurs.

Country Level

Generally, almost all countries' IBs do not disclose whether their audit committee is involved in providing the risk management oversight function, as audit disclosure has been very low in IBs in most countries, evidenced through its mean index disclosure of 0.26. Generally, this could probably be due to the inappropriate composition of the audit committee or a lack of audit resources to provide oversight.

As shown in the Table 5.24, no countries are classified in either the 'very high' or 'high' audit disclosure category and most of the countries (86%) fall in the 'very low'

category. The top disclosure ranking of 0.67 is claimed by Malaysia. The relatively low disclosure results from poor disclosure on: 'external audit', 'the appointment process of the audit committee', and 'the audit committees' profiles are not disclosed by most banks'. By referring to the results, it should be noted that IBs need strong directives to enforce disclosure, specifically in audit areas, as the gist of doing Islamic finance is to ensure *Shari'ah* compliance *vis-à-vis* transparency.

Table 5.24: Disclosure Results on 'Audit' Dimension at Country Level

Country	Audit Committee	Country	Audit Committee	Country	Audit Committee
Malaysia	0.670	Pakistan	0.299	Qatar	0.097
Turkey	0.458	Indonesia	0.260	Sudan	0.070
Jordan	0.398	Saudi	0.255	Egypt	0.068
UK	0.396	Bangladesh	0.245	Kuwait	0.065
Bahrain	0.333	UAE	0.196	Yemen	0.045

Mean = 0.26

5.4.4. Findings on Disclosure on 'Reporting-Accounting and Disclosure'

Bank Level

The mean index for the 'reporting and accounting' dimension is 0.74, reflecting that most banks have their own benchmarks in terms of reporting for accounting and disclosure. As presented in Table 5.25, 46% of the IBs are in the 'very high' disclosure group. IBB, EIIB, QIB, IIAB are among the 28% of IBs that score full indexes in this dimension as reflected by disclosures in all the constructs under this dimension. As evidenced through the 'high' disclosure index, nearly half of the IBs have some credentials in their official reporting and communications.

Table 5.25: Disclosure Results on 'Reporting-Accounting and Disclosure' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
IBB	1.00	Ithmaar	1.00	BLME	0.94	Alinma	0.85	AlBaraka (Sud)	0.67	Kuwait Int.	0.30
EIIB	1.00	Capinnova	1.00	Rayan	0.94	Hilal	0.83	Jadwa	0.64	DIB	0.28
QIB	1.00	ADIB (Abu Dhabi IB)	1.00	Eskan	0.94	Kuveyturk	0.81	Meezan	0.61	Al-Shamal	0.25
IIAB	1.00	Al-Arafah	1.00	As-Salam	0.92	IBQ	0.78	Islami Bank Bangladesh	0.56	Faisal (Sud)	0.22
BIMB	1.00	Al-Falah	1.00	AlBaraka	0.89	KFH (Bah.)	0.78	Faisal (Egy)	0.56	Shah Jalal	0.11
CIMB	1.00	AlRajhi	0.97	Asya	0.89	Emirates IB	0.78	Bujr	0.53	AlBaraka (Egy)	0.11
RHB	1.00	QIIB	0.96	AlJazira	0.89	BISB	0.75	JIB	0.50	BSM (Bank Shariah Mandiri)	0.00
ABIB (Bah.)	1.00	Affin	0.96	HLIB	0.89	Boubyan	0.75	JDIB	0.44	BNI Syariah	0.00
Khaleeji	1.00	Gatehouse	0.94	ABCIB	0.86	Tadamon	0.69	Muamalat	0.33		

Mean = 0.74

As can be seen, 16% of the IBs score 'very low' on disclosure in this dimension. JDIB, Kuwait Int., and DIB are among the IBs that score very poorly in the reporting dimension. This is mainly triggered by the absence of constructs such as: statement on transparency and disclosure, the board's accountability of the financial statements, and absence of statement of accounting in accordance with internationally accepted standards.

Country Level

The country level findings on the reporting and accounting disclosure dimension are depicted in Table 5.26. As can be seen, the sample mean disclosure index of 0.68 indicates that most countries adhere to certain rules in terms of reporting with regards to accounting and disclosure. As presented in Table 5.26, the country disclosure in this dimension is quite 'high' at 72 % with the UK ranking the top followed by Malaysia, Qatar, and Bahrain which are all active players in gaining competitive advantages in order to capture Islamic niche markets. This indicates a relatively 'high' reporting and accounting standard adhered to by countries with regards to providing Islamic products. However, Sudan, Egypt, and Indonesia fall in the 'very low' category, lagging behind at 0.39, 0.33, and 0.12 respectively on account of understated constructs. This is particularly attributed to an absence of disclosure on statements such as 'adherence to international accounting standard', 'undisclosed

statement on transparency and disclosure', as well as statements on the 'comprehensiveness of policies and procedures'.

Table 5.26: Disclosure Results on 'Reporting-Accounting and Disclosure' Dimension at Country Level

Country	Reporting	Country	Reporting	Country	Reporting
UK	0.976	Saudi	0.837	Kuwait	0.556
Malaysia	0.971	Pakistan	0.713	Bangladesh	0.556
Qatar	0.919	Yemen	0.694	Sudan	0.394
Bahrain	0.909	UAE	0.684	Egypt	0.333
Turkey	0.861	Jordan	0.611	Indonesia	0.121

Mean = 0.68

5.4.5. Findings on Disclosure on 'Market and Liquidity Risk' Dimension

Bank Level

The disclosure findings on 'market and liquidity risk' dimension are depicted in Table 5.27. At 0.76, the sample mean disclosure index for 'market and liquidity risk' is 'high'. This is not unexpected as market and liquidity risk is always one of the key risk areas that banks have to take care off. As presented in Table 5.27, 66% of the IBs show very 'high' disclosures in this dimension, where 32 out of 33 IBs have a full index score. This reflects the fact that banks have an appropriate market and liquidity risk structure in place to meet present and future financial obligations. The 'high' disclosure reflects that the banks have, to a certain extent, ascertained liquidity to address risk exposures. Through disclosure, the banks try to portray their strong commitment in undertaking accountability in market and liquidity risks. As these are banks with strong credentials, a full disclosure on their risk undertaking helps to strengthen market confidence, as acquiring investments from the niche markets is equally as important as restoring trust in the banking system.

Table 5.27: Disclosure Results on 'Market and Liquidity Risk' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
AlBaraka	1.00	Alinma	1.00	BISB	1.00	Emirates IB	1.00	Bujr	0.54	AlBaraka (Sud)	0.25
Asya	1.00	QIB	1.00	As-Salam	1.00	Al-Arafah	1.00	Jadwa	0.50	Kuwait Int.	0.22
Kuveyt Turk	1.00	Rayan	1.00	Khaleeji	1.00	Al-Falah	1.00	JIB	0.50	Muamalat	0.17
Gatehouse	1.00	QIIB	1.00	Ithmaar	1.00	Tadamon	1.00	IIAB	0.50	Islami Bank Bangladesh	0.17
BLME	1.00	BIMB	1.00	Eskan	1.00	Faisal (Egy)	1.00	ABIB (Bah.)	0.50	JDIB	0.00
IBB	1.00	CIMB	1.00	Capinnova	1.00	AlBaraka (Egy)	1.00	DIB	0.50	BSM (Bank Shariah Mandiri)	0.00
EIIB	1.00	RHB	1.00	KFH (Bah.)	1.00	ABCIB	0.92	Hilal	0.50	BNI Syariah	0.00
AlRajhi	1.00	Affin	1.00	Boubyan	1.00	IBQ	0.71	Meezan	0.38	Al-Shamal	0.00
AlJazira	1.00	HLIB	1.00	ADIB (Abu Dhabi IB)	1.00	Faisal (Sud)	0.67	Shah Jalal	0.33		

Mean = 0.76

As Table 5.27 depicts, the remaining 34% of IBs fall into both the categories of 'high' and 'moderate'. This implies that banks such as IBQ, Dawood, and Jadwa, for instance, do not profoundly disclose the technical aspects of the risk. An absence of disclosures on 'risk qualification', 'risk appetite', 'risk assumptions' and 'risk models' could partly be attributed to inadequate resources in this risk area.

With respect to the IBs in the 'very low' disclosure group, Meezan, Shah Jalal, and Kuwait Int. are among the 18% of IBs that do not show much information on market and liquidity risks. The banks do not communicate information on constructs such as: 'risk quantification that describes the risk appetite', 'risk measures', and 'risk assumptions'. This could be due to a lack of standards in reporting and communication as well as inadequate risk experts in this area. Nevertheless, it is noted that the reporting seems to be more comprehensive in nature towards the later years of the 2000s.

Country Level

As shown in Table 5.28, the sample mean disclosure index of 0.68 may reflect that most countries have stringent risk management practices. As shown, 43% of the IBs score 'very high' in disclosure in this dimension. Turkey ranks top followed by the

UK and Malaysia. 'High' indexes observed in Bahrain, Qatar, Saudi Arabia, and UAE could also imply that they have been proactive in this risk area in strengthening their efforts to capture the Islamic niche markets. The high disclosure could also be triggered by regulatory requirements, which require IBs to comply with certain reporting rules by furnishing qualitative and quantitative risk information.

Table 5.28: Disclosure Results on 'Market and Liquidity Risk' Dimension at Country Level

Country	Mkt/Liq.Risk	Country	Mkt/Liq.Risk	Country	Mkt/Liq.Risk
Turkey	1.000	Bahrain	0.990	Pakistan	0.639
UK	1.000	Qatar	0.922	Bangladesh	0.567
Malaysia	1.000	Saudi	0.867	Jordan	0.500
Yemen	1.000	UAE	0.846	Sudan	0.273
Egypt	1.000	Kuwait	0.667	Indonesia	0.061

Mean = 0.76

5.4.6. Findings on Disclosure on 'Credit Risk' Dimension

Bank Level

The relatively 'high' disclosure with mean index 0.82 in Table 5.29 implies that most IBs, especially those which are mainly involved in retail banking, strongly prioritise credit risk disclosure as most banks want to portray their transparent credit risk management to keep up with their stakeholders' expectations. Based on Table 5.29, 78% of IBs score a disclosure index of 0.75 and above. Out of this percentage, Al Baraka, Asya, Kuveyturk are among the 37 IBs, which score 'very high' disclosure index in this dimension.

This indicates that credit risk plays a significant role in the IBs: the way credit risk is managed is very important as it reveals the financial health of the banks; especially to stakeholders and shareholders alike and hence this demands adequate disclosure.

Table 5.29: Disclosure Results on 'Credit Risk' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
AlBaraka	1.00	Alinma	1.00	Affin	1.00	Capinnova	1.00	Faisal (Egy)	1.00	BNI Syariah	0.40
Asya	1.00	QIB	1.00	HLIB	1.00	KFH (Bah.)	1.00	Albaraka (Egy)	1.00	AlBaraka (Sudan)	0.25
Kuveyturk	1.00	Rayan	1.00	ABIB (Bah.)	1.00	Boubyan	1.00	Jadwa	0.80	JIB	0.20
Gatehouse	1.00	IBQ	1.00	BISB	1.00	ADIB (Abu Dhabi IB)	1.00	Meezan	0.75	Shah Jalal	0.20
BLME	1.00	QIIB	1.00	As-Salam	1.00	Hilal	1.00	Faisal (Sud)	0.67	JDIB	0.00
IBB	1.00	IIAB	1.00	Khaleeji	1.00	Emirates IB	1.00	Muamalat	0.50	BSM (Bank Shariah Mandiri)	0.00
EIIB	1.00	BIMB	1.00	Ithmaar	1.00	Al-Arafah	1.00	DIB	0.50	Islami Bank Bangladesh	0.00
AlRajhi	1.00	CIMB	1.00	Eskan	1.00	Al-Falah	1.00	Bujr	0.50	Al-Shamal	0.00
AlJazira	1.00	RHB	1.00	ABCIB	1.00	Tadamon	1.00	Kuwait Int.	0.47		

Mean = 0.82

Country Level

The findings on credit risk dimension disclosure are depicted in Table 5.30, which shows that the sample countries have a mean disclosure of 0.78 on the 'credit risk' dimension. This may imply that releasing information on credit risk has been accepted by many countries as one of the ways to obtain market confidence.

Table 5.30: Disclosure Results on 'Credit Risk' Dimension at Country Level

Country	Credit Risk	Country	Credit Risk	Country	Credit Risk
Turkey	1.000	Yemen	1.000	Pakistan	0.750
UK	1.000	Egypt	1.000	Bangladesh	0.480
Qatar	1.000	Saudi	0.947	Jordan	0.350
Malaysia	1.000	UAE	0.846	Indonesia	0.291
Bahrain	1.000	Kuwait	0.771	Sudan	0.273

Mean=0.78

The sampled IBs from Turkey, UK, Malaysia, Qatar, and Bahrain in particular are among the IBs, which score 'very high' on the disclosure index in the credit dimension. This can be explained by the fact that the regulators of the countries in the 'very high' disclosure group are more prescriptive towards improving credit risk disclosure. It is implied that credit risk disclosure could build up their countries'

financial credibility, as it is viewed that consistency in credit risk disclosure is one of the strategies and competitive ways in trying to attract investments.

However, it is important to note that countries with low credit risk disclosures such as Jordan and Bangladesh are not necessarily doing badly if not because of their small sample sizes that have affected their index scores. Jordan may need a few more years to strengthen their banking position after a few years in debt restructuring and hence disclosure will probably occur after that.

5.4.7. Findings on Disclosure on 'Other Risks' Dimension

Bank Level

As can be seen in Table 5.31, the mean index disclosure score of 0.87 on the 'other risks' dimension implies good risk management on other risks (apart from the primary risks mentioned above), despite the fact that the mean is quite distorted due to the minimal constructs in this dimension. However, it is viewed that disclosure on this dimension is justifiably significant. The inclusion of this dimension is to set the precedence on examining disclosure on other risks apart from market, liquidity and credit risks to ensure that banks give comprehensive risk reporting. Through this transparent communication, the credibility of risk reporting will be higher as no risk is obscured from the public and stakeholders *etc*.

Table 5.31: Disclosure Results on 'Other Risks' Dimension at Bank Level

Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index	Bank	Index
Asya	1.00	Jadwa	1.00	Affin	1.00	ABCIB	1.00	Tadamon	1.00	Bujr	0.50
Kuveyt Turk	1.00	QIB	1.00	HLIB	1.00	Capinnova	1.00	Faisal (Egy)	1.00	Kuwait Int.	0.33
Gatehouse	1.00	Rayan	1.00	BNI Syariah	1.00	KFH (Bah.)	1.00	AlBaraka (Egypt)	1.00	AlBaraka (Sud)	0.25
BLME	1.00	IBQ	1.00	ABIB (Bah.)	1.00	Boubyan	1.00	QIIB	0.83	JDIB	0.00
IBB	1.00	JIB	1.00	BISB	1.00	ADIB (Abu Dhabi IB)	1.00	Muamalat	0.75	BSM (Bank Shariah Mandiri)	0.00
EIIB	1.00	IIAB	1.00	As-Salam	1.00	Hilal	1.00	Shah Jalal	0.75	Islami Bank Bangladesh	0.00
AlRajhi	1.00	BIMB	1.00	Khaleeji	1.00	Emirates IB	1.00	Meezan	0.75	Al-Shamal	0.00
AlJazira	1.00	CIMB	1.00	Ithmaar	1.00	Al-Arafah	1.00	Faisal (Sud)	0.67		

Mean = 0.86

Country Level

As can be seen in Table 5.32, the sample countries have a mean disclosure index of 0.84 indicating that most countries have already disclosed other types of risks in their communications. As shown in Table 5.32, 50% of the countries show 'very high' index disclosure on other risks. Turkey, UK, SA, Malaysia, Bahrain and Oman have full index scores while other countries in the sample also show relatively 'high' disclosure in this dimension. Most banks in these countries cover other risks, as these are part of their identified key risk areas that need to be communicated to the stakeholders and investors etc.

Table 5.32: Disclosure Results on 'Other Risks' Dimension at Country Level

Country	Other Risk	Country	Other Risk	Country	Other Risk
Turkey	1.000	Yemen	1.000	Pakistan	0.750
UK	1.000	Egypt	1.000	Kuwait	0.714
Saudi	1.000	Qatar	0.967	Bangladesh	0.700
Malaysia	1.000	UAE	0.846	Indonesia	0.545
Bahrain	1.000	Jordan	0.750	Sudan	0.273

Mean: 0.84

5.4.8. Overall Results (RMI)

After presenting the individual risk management disclosure dimensions on bank and country level for the sampled banks and countries, this section presents overall results for the risk management disclosure practices.

Bank Level

As shown in Table 5.33, the modest mean disclosure of 0.57 for overall risk management disclosure performance is very much affected by the scores from the banks in the 'very low' disclosure group. Boubyan, Meezan, Shah Jalal, JDIB, Jadwa, JIB, DIB, Islami Bank, Kuwait Int, amd BNI Shari'ah are among the 28% (13) of the banks in the 'very low' group whose scores are in the range 0.45 to 0.01.

Table 5.33: Overall Bank Level Results for all the Dimensions

Bank	Ov.RMI	Bank	Ov.RMI	Bank	Ov.RMI	Bank	Ov.RMI	Bank	Ov.RMI	Bank	Ov.RMI
CIMB	0.908	Affin	0.789	KFH (Bah.)	0.688	Eskan	0.625	Boubyan	0.446	AlBaraka (Egy)	0.300
BIMB	0.888	BLME	0.779	Kuveyt Turk	0.683	IIAB	0.608	Meezan	0.429	Islami Bank Bangladesh	0.267
EIIB	0.883	ABCIB	0.763	Gatehouse	0.675	Al-Arafah	0.600	Muamalat	0.421	Faisal (Sud)	0.261
HLIB	0.867	Hilal	0.742	AlJazira	0.671	Emirates IB	0.567	Tadamon	0.400	Kuwait Int.	0.217
ABIB (Bah.)	0.858	Khaleeji	0.733	Al-Falah	0.650	QIIB	0.544	Shah Jalal	0.350	BNI Syariah	0.200
RHB	0.850	Ithmaar	0.729	IBB	0.638	IBQ	0.529	JDIB	0.342	AlBaraka (Sud)	0.171
Al Baraka	0.817	AlRajhi	0.725	BISB	0.629	Bujr	0.513	Jadwa	0.333	Al-Shamal	0.054
Asya	0.804	Alinma	0.706	As-Salam	0.629	Rayan	0.508	JIB	0.325	BSM (Bank Shariah Mandiri)	0.013
ADIB (Abu Dhabi IB)	0.800	QIB	0.700	Capinnova	0.628	Faisal (Egy)	0.450	DIB	0.308		

Mean = 0.57

Table 5.33 shows that only one bank scores ‘very high’ while 17 banks are classified as ‘high’. A total of 12 banks have ‘moderate’ scores and the remaining 5 banks indicate ‘low’ scores in overall risk management disclosure. Looking at the ‘high’ disclosure index of 0.91, this may imply that CIMB and other banks with ‘high’ disclosure, such as BIMB, EIIB, HLIB, ABIB, and RHB use disclosure as one of their strategies to increase the banks’ access to capital markets. To a certain extent, this may imply that these banks have very strong market discipline, hence ‘high’ risk management disclosure is observed in this group. Theoretically, disclosure enhances the attractiveness of the banks’ shares to current and prospective investors. Beyond this, the investors can reduce their costs of information seeking pertaining to the banks.

Banks being categorised in the ‘moderate’, ‘low’, and ‘very low’ risk management disclosure groups, whose scores are in the range of 0.69 to 0.60, 0.57 to 0.51, and 0.45 to 0.01 respectively, may reflect that they are still struggling with the RM structure. The disclosure level hinges on the banks’ safety net, as they have to weigh the repercussions of revealing proprietary and strategic information to competitors and potential new entrants. This could probably be the reason why banks like DIB and JIB have to reform to sustain their strength.

Country Level

As far as the banking system is concerned, risk management has always been relevant. However, on a country basis, the mean disclosure index of 0.51 in the overall risk management is considerably unimpressive considering the pervasive impact risk management can impose on the robustness of the financial system. Nevertheless, as frequently mentioned, the low mean risk management disclosure index could probably be due to technical distortions resulting from the small sample size as well as the limited number of published annual reports.

Table 5.34: Overall Country Level Results for all the Dimensions

Country	Overall RMI	Country	Overall RMI	Country	Overall RMI
Malaysia	0.864	Qatar	0.572	Yemen	0.400
Turkey	0.768	UAE	0.568	Egypt	0.375
UK	0.754	Pakistan	0.531	Kuwait	0.348
Bahrain	0.690	Bangladesh	0.433	Indonesia	0.212
Saudi	0.602	Jordan	0.400	Sudan	0.153

Mean: 0.51

As far as disclosure is concerned, the extent and nature of RM disclosure relates to how 'high' the risk management structure is put in place. This may imply that countries like Malaysia, UK, Bahrain and Turkey have 'high' disclosure as the country has a long-established risk management infrastructure in supporting the banks' operations. On another note, the 'high' disclosure demonstrated by these banks, to a certain extent, implies that these banks undertake rigorous efforts in promoting their banks' market value as well as improving returns, as it is perceived that disclosure has the probability of influencing the banks' share price and their expected stock return.

It is noted that the banks that score better in risk management disclosure have supportive government in terms of safeguarding the banks' financial health. Countries like UK and Malaysia for instance, have government safety nets such as deposit insurance in place to improve the banks' risk management. As for countries with 'moderate' risk management disclosures like Bahrain and Saudi Arabia, the risk management initiatives started sometime later, hence, it does not reflect quite well as of yet. Qatar, UAE and Pakistan score quite 'moderate' in the overall disclosure while Bangladesh, Kuwait, Jordan, Sudan and Indonesia fall in the 'very low' disclosure

group in the overall RMI dimension, with scores ranging from 0.12 to 0.42. This may imply that these banks need to play more persistent roles in undertaking risk management apart from their government's supportive role to complement their efforts.

From another perspective, the disclosure level is very much affected by its own repercussions after the disclosure exercise takes place. It is noted that disclosure affects the risk taking incentives, since the banks will have informed depositors instead who monitor the bank's balance sheet. In a way, this is considered positively because the banks can control its asset volatility and bank failures can be avoided.

However, to a certain extent, the presence of informed markets may have effects on the banks' sustainability as disclosure may impinge on the banks' strategic advantage to potential competitors. This could possibly be the reason as to why in some countries banks have yet to achieve a certain level of institutional base, as Sudan, Pakistan and Bangladeshi banks seem to be adamant in not disclosing very much information.

5.5. REFLECTING ON THE DISCLOURSE FINDINGS FOR CGI AND RMI

After individually presenting the results for CGI and RMI and discussing the overall performance in both the indices, this section aims to provide a comparative perspective between the performances of RMI and CGI.

It should be noted that the disclosure result from the overall CGI is less encouraging than its RMI counterpart. As shown in Table 5.35 below, the overall CGI disclosure bank-wise and country wise is lower than the overall RMI disclosure. This could possibly be due to the following factors:

In general, it can be argued that the CG area is more revealing and human-related, which makes disclosure harder as compared to the RM side. The difficulty level in disclosing CG could be due to the fact that the CG construct is more comprehensive and detailed, since it covers a wider spectrum of the banking operations, *i.e.* from the selected individual board's profiles to the banks' mission, operations, supports, structures, and many other dimensions. As such, disclosure may require higher commitment and co-operation from more diverse parties.

As far as reporting is concerned, non-standardisation in terms of CG framework itself could also affect the disclosure level. The CGI is more affected than the RMI because CG has more dimensions for which to work out the average. In addition, poor CG disclosures can be also attributed to the quality of reporting itself, which relates to the ability to report and communicate well. However, this depends on the banks' policies too with regards to how transparent they want the banks to be. Furthermore, the regulative environment should also be considered in terms of the amount of disclosure required from the Islamic banks as it seems that, in particular, GCC regulative bodies do not impose high disclosure expectations for either of the disclosure areas.

Table 5.35: Comparing CGI and RMI Results

	CGI		RMI	
Performance Classification	**COUNTRY**	**BANK**	**COUNTRY**	**BANK**
Very High	-	-	-	1. CIMB
High	-	1. ABIB 2. BIMB 3. KFH	1. Malaysia 2. Turkey 3. UK	1. BIMB 2. EIIB 3. HLIB 4. ABIB 5. RHB 6. AlBaraka 7. Asya 8. ADIB 9. Affin 10. BLME 11. ABCIB 12. Hilal 13. Khaleeji 14. Ithmaar 15. AlRajhi 16. Al Inma 17. QIB
Moderate	1. Malaysia	1. CIMB 2. JDIB 3. BISB 4. RHB 5. JIB	1. Bahrain 2. S.Arabia	1. KFH (Bah.) 2. Kuveyt Turk 3. Gatehouse 4. Al Baraka 5. Al Falah 6. JBB 7. BISB 8. As-Salam 9. Al-Arafah 10. IIAB 11. Capinnova 12. ESKAN
Low	1. Bahrain 2. Jordan	1. Ithmaar 2. Khaleeji 3. BNI Sharia 4. HLIB	1. Qatar 2. UAE 3. Pakistan	1. Emirates 2. QIIB 3. IBQ 4. Bujr 5. Rayan
Very Low	1. Indonesia 2. UK 3. Turkey 4. S.Arabia 5. UAE 6. Pakistan 7. Qatar 8. B'ladesh 9. Sudan 10. Egypt 11. Kuwait 12. Yemen	1. Salam 2. EIIB 3. Al Baraka 4. Affin 5. Muamalat 6. Gate Hse 7. Hilal 8. ADIB 9. ABCIB 10. BLME 11. Capinnova 12. QIB 13. Aljazira 14. Islami 15. Al Inma 16. Eskan 17. Asya	1. Bangladsh 2. Jordan 3. Yemen 4. Egypt 5. Kuwait 6. Indonesia 7. Sudan	1. Faisal(Eg) 2. Boubyan 3. Meezan 4. Muamalat 5. Tadamon 6. S.Jalal 7. JDIB 8. Jadwa 9. JIB 10. DIB 11. Albara(E 12. Islami 13. Faisal(Su) 14. KuwaitInt 15. BNISya 16. Albara(S) 17. AlShamal

	CGI		RMI	
Performance Classification	**COUNTRY**	**BANK**	**COUNTRY**	**BANK**
		18. Al Rajhi 19. Meezan 20. BIMB 21. Dawood 22. BSM 23. IIAB 24. Al Falah 25. Rayan 26. DIB 27. KuveyT 28. Jadwa 29. Shah Jalal 30. Al Arafah 31. QIIB 32. IBQ 33. AlBarakaE 34. EmiratesIs. 35. Kuw.Int. 36. Al Shamal 37. IBB 38. Albarak(S) 39. Boubyan 40. Tadamon 41. Faisal(E		18. BSM

As for RMI, the information in the financial statements is rather standard, and thus much easier to develop an understanding of regarding RMI. In addition, banks have the international accounting standard to comply with in relation to risk management, as it can have immediate effects on the robustness of the bank. In other words, the finance-related information used in the reporting seems to be more mandatory in nature. However, unless required, banks do not necessarily have to go for full CG compliance in terms of the type of information to disclose. Thus, risk management, in fact, is part of the financial statement, which is the main focus of annual reports. As far as financial statements are concerned, the standards have been long established, and therefore, they always have the same principles to follow. However, this might not be the case for CG because is no mandatory or universal standard that requires banks to use in the disclosure of their annual reports for CG.

As the results show, in terms of compliance, most countries do not have a 'higher' compliance in CG as opposed to RM. This may imply the lack or absence of CG awareness. Nonetheless, more regulatory intervention could be seen to play a major role in providing directives to promote best practices through CG. On another note,

the banks themselves may place less of a priority on CG compliance and hence less on CG disclosure. Banks may disclose better in RM as it has direct impacts on investment so that they can be more competitive. As for CG, some banks may not choose to go for best practices yet because they would rather focus on how to survive and sustain their presence in the business. Thus, communicating CG related information, which stresses on best practices, is somehow considered secondary after RM. However, as the recent financial crisis has shown, developing an efficient CG and disclosing the necessary information is an essential factor for the robust development and functioning of the financial system.

5.5.1. Reflecting on the Ranking at Bank Level

This section aims to provide further reflections on the results by classifying and ranking the banks in terms of their CGI and RMI level.

Very High or Best Disclosure Practice

As shown in Table 5.35, no banks managed to score 'very high' disclosure in the overall CGI. This could possibly due to the nature of CG: banks may choose not to disclose information such as the boards' profile because of the perception that disclosing such information is unnecessary and that it seems to be more voluntary in nature instead of mandatory. However, individually there are many banks with 'very high' CGI disclosures but this is offset in the mean calculation by a few banks with 'very low' ones.

Table 5.35 shows that 'very high' RMI disclosure is accounted by CIMB, whose RMI performance can be attributed to the bank's ambitious mission to be the premier global market leader. Being an example of best practice, CIMB may have used disclosure to demonstrate its good risk management practices and diligent risk oversight. In a way, it tries to harness transparency to capture the niche market by showing that a good risk management structure is in place in order to get market confidence in the global market in order to strengthen their business and growth.

High Disclosure Practice

As for 'high' disclosure level, it is noted that banks are still struggling towards disclosure in CGI as opposed to RMI. There are only 3 banks with 'high' CGI namely: ABIB, BIMB and KFH. ABIB has always been at the forefront, when it comes to maintaining the highest international standards of corporate governance, consistent with its presence in the country that is responsible for issuing IB guidelines. As for BIMB, which has been in the banking field for about three decades, its disclosure reflects the bank's maturity, which is highlighted through bank objectives and reputation that are based on the underlying principles of CG. The disclosure is also implied in its mission statement. KFH on the other hand, portrays 'very high' disclosure to support its strong presence internationally. Based on the disclosure level, this gives the impression that banks with 'high' disclosure should be able to meet demands from the market through their maturity and oversight.

Unlike the overall CGI, the overall RMI is more representative as reflected in Table 5.35. A total of 17 banks show 'high' disclosure in RMI and this includes: BIMB, EIIB, HLIB, ABIB, RHB, and AlBarakaTurk. The ownership structure may carry some weight towards disclosure. Occasionally, public-owned banks may demonstrate higher disclosure than privately-owned banks. However, this is not always the case as privately owned banks such as Kuveyt Turk place a high importance on risk management disclosure as it moves into new business strategies in Islamic retail and in corporate banking.

Moderate Disclosure Practice

For the overall CGI disclosure, 'moderate' is the highest ranking classification attained. Factors such as coverage of annual reports and the government policies could be some of the contributing factors. The quality of the information communicated in annual reporting influences the disclosure level, for instance in the form of its coverage, presentation and attestation, and the availability of information and its relevancy for disclosure. As shown in Table 5.35, there are 6 banks: CIMB, DJDIM, BISM, RHB, JIB, and Ithmaar that score 'moderate' in the overall CGI disclosure. It is observed that these banks have something in common, as they are market players in the IB industry. As for RM, the 'moderate' overall RMI disclosure

is represented by 3 banks: KFH (Bah.), Kuveyt Turk, and Gatehouse. These banks have different settings in terms of corporate structure and economic background and this affects the disclosure levels. However, they all have something in common. That is that they have to abide by their countries' laws. Kuveyt Turk adopts its own country's CG code, while Gatehouse is in the same situation in which it has to abide by UK law, *i.e*. to adhere to the FSA despite it being an Islamic institution. Thus, the nature of law, in each jurisdiction, has a direct impact on the results, which implies also that political economy determines the nature and the quantity of information communicated

Low Disclosure Practice

As shown in Table 5.35, 8% of the sampled IBs have 'low' overall CGI disclosure score. This includes Ithmaar, HLIB, Khaleeji, and BNI Shariah. The 'low' disclosure may have been explained by the restructuring exercise which took place prior to 2011 in the case of Ithmaar, while for others it is more to do with low disclosure in certain dimensions in certain years.

For the overall RMI performance, 5 IBs demonstrate 'low' disclosure and this includes: Emirates Islamic, QIIB, IBQ, Bujr and Rayan. As for Emirates Islamic this could probably due to it being new in the IB industry, as it has just converted to an IB in the year 2004. Presumably, it needs more time to develop its practices. As for Bujr, this could be attributed to less comprehensive coverage in the annual reports in its earlier years, mainly prior to the year 2010.

Very Low Practice

The overall CGI disclosure is 'very low' for the remaining 41 banks, which constitutes 77% of the sampled banks. Such a score should cause some consideration and worry. Among the 'very low' disclosure of banks are: Al Salam, EIIB, AlBaraka (Turk), and Affin. In general, it is perceived that most of the banks in this group have not been doing very well in the *Shari'ah* theme and this really affects the disclosure level for the overall CGI. The 'very low' disclosure group for the overall RMI is represented by 18 banks, which include Faisal (Egypt), Boubyan, and Meezan. It is noted that Faisal (Egypt), Boubyan, Meezan and a few more banks have not been doing very well in terms of their annual reporting of which pertinent information is

not presented adequately, especially on the structure of the bank. To a certain extent, this may imply the shortcomings in the CG awareness in these banks.

5.5.2. Reflecting on the Ranking by Country

In providing further meaning to the results, this section aims to provide further reflections on the results by classifying and ranking the sampled countries in terms of their CGI and RMI level.

As shown in Table 5.35, no countries have a 'very high' disclosure in either CGI or RMI performance, as the CGI and RMI mean scores are low, at 0.25 and 0.51 respectively as reflected in Table 5.35. The discussion in this section is based on the performance level of the sampled countries in terms of CGI and RMI.

Very High or Best Practice

As shown in Table 5.35, no country shows a 'very high' disclosure in the overall CGI. Even though there are a number of banks in each country with 'very high' CGI, this is offset by some banks in the same countries which have 'very low' CGI. This is attributed to the 'very low' disclosure in certain dimensions such as *Shari'ah* and ethics. For example, there is no doubt that some banks have shown very good progress on CG compliance dimensions (as observed in the later stage of the year 2000s); however, this was not the case before the banks adopted CG principles. As for RMI, no country demonstrates 'very high' disclosure on RMI. This could be attributed to a few factors.

Similar to CGI, there is always the case that some banks in the countries have 'very high' disclosure but this is offset by the banks with 'very low' scores. Annual reporting also contributes towards disclosure, as some banks do not have an adequate coverage of RM area in the ARs.

High Performance

Similarly, none of the countries show 'high' disclosure in CGI. There are also cases that some countries do not even have a score for any of the CG statement, and this gives the impression that they have not adopted a CG code. Perhaps this is due to the absence of CG awareness or the failures of the regulative bodies, since CG is not

mentioned anywhere in the annual reports and this could be one of the reasons why no countries indicate 'high' CGI disclosure.

On the other hand, Malaysia, Turkey, and the UK show 'high' RMI disclosure. This could be attributed to regulative intervention. In addition, the socio-economic status of the host countries itself may influence the disclosure level. For this, Malaysia, Turkey, and UK have reached certain socio-economic levels that require best practises to be in place in IBs to be able to compete in their respective countries. As far as these countries are concerned, they have strict policies in the form of regulatory directives that ensure compliance on RM.

In reflecting on the sampled countries through their particular economic progress and democratic consolidation level, there is a possibility of country-specific factors that affect RMI and also of CGI disclosure. For example, developed countries, such as the UK, are more open in terms of disclosing information. This reflects that some initiatives must have been put in place to push these 3 countries towards current disclosure levels. Malaysia for instance has been very committed in its initiatives to ensure high standards in its IB operations.

As far as the overall RMI is concerned, improving disclosure should be one of the strategies of the countries in question to be competitive in trying to attract Islamic investment funds. Malaysia has come up with series of financial master plans for the financial sector. As for Turkey, the banks have moved some steps ahead, following their adoption of a CG code. They have implemented their own corporate governance code, a framework that has to be adhered at bank levels in the country. Similarly, the UK has been very serious in maintaining transparency and thus disclosure is in one of the agendas to deal with.

Moderate Practice

The ranking 'moderate' is the best classification attained by the overall CGI disclosure. This is represented by Malaysia with its 'moderate' score in the overall CGI. To a certain extent, from the CG viewpoint, this somehow shows that Malaysia is comparatively more transparent than any other country. This is partly due to government initiatives to help support banking operations. The regulator has been

persistent and consistent in ensuring the adequacy of guidelines and directives for the banks to adhere to.

As the results show, the 'moderate' classification for the overall RMI is represented by two countries: Bahrain and Saudi Arabia. This is anticipated as Bahrain is the home for guidelines while Saudi Arabia's 'high' disclosure is because of ownership structure. This may imply that for countries with banks that have high privately-held shareholding, the level of disclosure is determined by the discretion of the main shareholders.

Low Practice

Bahrain and Jordan show 'low' disclosures in CGI. Bahrain is quite unexpected as this is the country from which IB standards and guidelines are issued through the AAOIFI. In addition, AAOIFI standards are mandatory for Bahraini Islamic banks. Nevertheless, there are some banks with no CG awareness, which brings down the country's disclosure level. Similar cases occur with Jordan when one sampled bank under-performed in CGI disclosure. The 'low' classification for the overall RMI is represented by Qatar, UAE, and Pakistan. Qatar also has the same problem as some banks in the country do not have good disclosure in risk management.

Very Low Performance

The overall CGI score is 'very low' for 12 countries. This includes: Indonesia, UK, Turkey, SA, and UAE. The reason could be due to lack of political will and regulative efficiency in the form of directives towards attaining best practices. In general, almost all banks in this disclosure group are from the countries that have not established their corporate governance code. As for RM, the overall RMI disclosure is 'very low' for 7 countries including: Bangladesh, Jordan, Kuwait, Sudan and Indonesia, and Egypt and Yemen. This could be due to similar reasons as CGI, *i.e.* some banks with 'very low' disclosure in these countries may affect the individual country's level of disclosure. It could be that for some banks, the necessity to improve their communications is not so pressing, which may be justified by the modesty and simplicity of its AR reporting.

5.6. SUMMARY OF THE EMPIRICAL FINDINGS

Having presented and discussed the empirical results by undertaking bank and country comparisons on the relationships between CG and RM, it is found that the performance of CGI is comparatively lower than that of the RMI performance, both bank-wise as well as country-wise. It is also found that the overall CGI mean and RMI mean country-wise is slightly lower compared to the ones bank-wise.

Since one of the objectives of this research is also to explore how CGI performance could relate to RMI performance and *vice versa*, the next section will deal with their relationship.

5.7. CORRELATIONS BETWEEN CORPORATE GOVERNANCE AND RISK MANAGEMENT DISCLOSURES

This chapter so far has focused on presenting the descriptive findings through an explorative motive and providing further meaning to the results through interpretation. This section aims to examine the strength of the relationship between the two variables; CG and RM. In other words, while individually the results are presented, this study at the same time, aims to locate whether there is any relationship between CGI disclosure and RMI disclosure; because it is hypothesised that a better CG environment should result in a better RM practice. In doing so, this chapter also provides the strength of the relationship between all the dimensions of CG and RM.

It should be mentioned that the correlation method is employed to measure the strength of the relationships, which is a technique used to examine the relationship between two variables (Pallant, 2010). A correlation exists when knowing scores for one variable helps to predict scores for the other. In order to establish the nature of the relationships, SPSS is employed of which the Spearman Rho tool is used on the same data (sample of 153 annual reports) to examine the correlations. It should be noted that proxies are used to represent each CG and RM.

The correlation tests in this section are run in both the bank and country comparison cases. Thus, the following findings are the outcomes of the tests on two sets of data: bank-wise and country-wise for CGI and RMI. The following sub-section proceeds with the results of the findings of the correlation.

5.7.1. Correlation between CGI and RMI at Bank-Level and Country-Level

Based on the correlation tests conducted in the bank comparison analysis, there is a modest relationship between CGI and RMI as depicted by the disclosure indices. As can be seen from the results, the coefficients are slightly above average; 0.587 using the Spearman Rho based analysis in Table 5.36 and 0.522 in the Pearson based estimation in Table 5.37. The results evidence that the relation between the two variables, CG and RM, are not incredibly strong as had been expected, despite the fact that the relationship seems to be significant. Thus, there is a statistically significant relationship as produced by both the estimation period, but the strength of the relationship stayed at medium level.

Table 5.36: Bank-Level Spearman's Rho Correlation[b] between CG and RM Scores

			CG	RM
Spearman's rho	CG	Correlation Coefficient	1.000	.587**
		Sig. (2-tailed)		.000
	RM	Correlation Coefficient	.587**	1.000
		Sig. (2-tailed)	.000	

Notes: **. Correlation is significant at the 0.01 level (2-tailed); b. Listwise N = 53

Table 5.37: Bank-Level Pearson Correlation[b] between CG and RM Scores

		CG	RM
CG	Pearson Correlation	1	.522**
	Sig. (2-tailed)		.000
	N	53	53
RM	Pearson Correlation	.522**	1
	Sig. (2-tailed)	.000	
	N	53	53

Notes: **. Correlation is significant at the 0.01 level (2-tailed)

Similarly, based on the test done on country comparison analysis using the disclosure indices developed, there is also a slightly above average correlation between CGI and RMI. Quite similar to the results of the bank's comparison, the country's result shows a correlation coefficient of 0.576 and 0.529 using Spearman Rho (Table 5.38) and

Pearson (Table 5.39) respectively. As before, despite having a significant relationship, these coefficients do not indicate any strong relationship.

Table 5.38: Country Level Spearman's Rho Correlation[b] between CG and RM Scores

			CG	RM
Spearman's rho	CG	Correlation Coefficient	1.000	.576*
		Sig. (2-tailed)		.025
	RM	Correlation Coefficient	.576*	1.000
		Sig. (2-tailed)	.025	

Notes: *. Correlation is significant at the 0.05 level (2-tailed); b. Listwise N = 15

Table 5. 39: Country-Level Pearson Correlation[b] between CG and RM Scores

		CG	RM
CG	Pearson Correlation	1	.529*
	Sig. (2-tailed)		.042
RM	Pearson Correlation	.529*	1
	Sig. (2-tailed)	.042	

Notes: *. Correlation is significant at the 0.05 level (2-tailed); b. Listwise N=15

5.7.2. Correlations between CGI Dimensions

This section proceeds with the results of the findings of the correlation estimation between CGI and its dimensions and also between the CGI dimensions. The results are depicted in Table 5.40 and Table 5.41.

5.7.2.1. Correlations between CGI and its dimensions at bank-level

Table 5.40 shows the correlation between CGI and its dimensions. The CGI, which is a proxy of corporate governance, has relatively strong correlations with 'Board composition' (r = .794, p = 0.000); 'Mission' (r = .696, p = 0.003); 'Board leadership' (r = .686, p = 0.000); '*Shari'ah* governance' (r = .674, p = 0.000); 'Ethical business' (r = .647, p = 0.000); 'Nomination committee' (r = .632, p = 0.000). However, CG has quite moderate relationships between '*Shari'ah* compliance' (r = .591, p = 0.000) and 'Board meeting' (r = .477, p = 0.000).

Table 5.40 also depicts the findings of the test between all other dimensions of CG. As seen from results, the correlation between the CG dimensions varies in strength. The 'Mission' has a correlation with 'Board composition' (r = .799, p = 0.000); 'Ethics' (r = .671, p = 0.000); 'Board leadership' (r = .625, p = 0.000); 'Nomination committee' (r = .586, p = 0.000); 'Board meeting' (r = .581, p = 0.000); '*Shari'ah* governance' (r = .444, p = 0.001) and '*Shari'ah* Compliance' (r = . 353, p = 0.000).

As indicated in Table 5.40, 'Board composition' has a correlation with 'board leadership'(r = .831, p = 0.000); 'Nomination committee' (r = .784, p = 0.000); 'Ethical business' (r = .682, p = 0.000); '*Shari'ah* governance' (r = .621, p = 0.000); 'Board meeting' (r = .538, p = 0.000) and '*Shari'ah* Compliance' (r = .471, p = 0.000).

It is noted that 'Board leadership' is correlated with 'Nomination committee' (r = .697, p = 0.000); 'Ethical business' (r = .623, p = 0.000); '*Shari'ah* Compliance' (r = .485, p = 0.000); '*Shari'ah* governance' (r = .484, p = 0.000) and 'Board meeting' (r = .398, p = 0.003).

As for 'board meeting', it is only correlated with only one dimension *i.e.* the 'Nomination committee' (r = .566, p = 0.000). Based on Table 5.40, 'Nomination committee' is correlated with '*Shari'ah* governance' (r = .517, p = 0.000); 'Ethical business' (r = .430, p = 0.001) and '*Shari'ah* compliance' (r = .425, p = 0.002).

Table 5.40 also shows that '*Shari'ah* governance' has slightly above average correlation with '*Shari'ah* compliance' (r = .632, p = 0.000) but very poor relationship with 'Ethical business' (r = .382, p = 0.005). The dimension '*Shari'ah* compliance' seems to have a very weak correlation with 'Ethical business' (r = .377, p = 0.005).

Table 5.40: Correlation Estimations between CGI and Dimensions and between Dimensions at Bank-Level

			CG	Mission	Board composition	Board leadership	Board meeting	Nomination committee	Shari'ah governance	Shari'ah compliance	Ethical business
Spearman's rho	CG	Cor.Coef	1.000	.696**	.794**	.686**	.477**	.632**	.674**	.591**	.647**
		Sig.		.000	.000	.000	.000	.000	.000	.000	.000
		N	53	53	53	53	53	53	53	53	53
	Mission	Cor.Coef	.696**	1.000	.799**	.625**	.581**	.586**	.444**	.353**	.671**
		Sig.	.000		.000	.000	.000	.000	.001	.010	.000
		N	53	53	53	53	53	53	53	53	53
	Board composition	Cor.Coef	.794**	.799**	1.000	.831**	.538**	.784**	.621**	.471**	.682**
		Sig.	.000	.000		.000	.000	.000	.000	.000	.000
		N	53	53	53	53	53	53	53	53	53
	Board leadership	Cor.Coef	.686**	.625**	.831**	1.000	.398**	.697**	.484**	.485**	.623**
		Sig.	.000	.000	.000		.003	.000	.000	.000	.000
		N	53	53	53	53	53	53	53	53	53
	Board meeting	Cor.Coef	.477**	.581**	.538**	.398**	1.000	.566**	.260	.120	.259
		Sig.	.000	.000	.000	.003		.000	.060	.391	.061
		N	53	53	53	53	53	53	53	53	53
	Nomination committee	Cor.Coef	.632**	.586**	.784**	.697**	.566**	1.000	.517**	.425**	.430**
		Sig.	.000	.000	.000	.000	.000		.000	.002	.001
		N	53	53	53	53	53	53	53	53	53
	Shari'ah governance	Cor.Coef	.674**	.444**	.621**	.484**	.260	.517**	1.000	.632**	.382**
		Sig.	.000	.001	.000	.000	.060	.000		.000	.005
		N	53	53	53	53	53	53	53	53	53
	Shari'ah compliance	Cor.Coef	.591**	.353**	.471**	.485**	.120	.425**	.632**	1.000	.377**
		Sig.	.000	.010	.000	.000	.391	.002	.000		.005
		N	53	53	53	53	53	53	53	53	53
	Ethical business	Cor.Coef	.647**	.671**	.682**	.623**	.259	.430**	.382**	.377**	1.000
		Sig.	.000	.000	.000	.000	.061	.001	.005	.005	
		N	53	53	53	53	53	53	53	53	53
Note: **. Correlation is significant at the 0.01 level (2-tailed).											

5.7.2.2. Correlations between CGI and its dimensions at country-level

Table 5.41 shows the correlation estimations country-wise. As can be seen, there are slightly weaker correlations between corporate governance and its dimensions as compared to the results of the bank-wise dataset. The CG has a strong correlation with 'Board composition' (r = .962, p = 0.000); 'Board leadership' (r = .950, p = 0.000); 'Nomination committee' (r = .897, p = 0.000); 'Ethical business' (r = .822, p = 0.000) and 'Mission' (r = .806, p = 0.000). CG also has a correlation with '*Shari'ah*

governance' (r = .732, p = 0.002); '*Shari'ah* compliance' (r = .680, p = 0.005) and 'Board meeting' (r = .595, p = 0.019).

Apart from the above relationships, as shown in Table 5.41, relationships between the CG dimensions are also observed. It seems that 'Mission' is highly correlated with 'Board composition' (r = .873, p = 0.000); 'Board meeting' (r = .793, p = 0.000); 'Board leadership' (r = .760, p = 0.001); and 'Ethical business' (r = .742, p = 0.002). There are also correlations with the 'Nomination committee' (r = .597, p = 0.019); '*Shari'ah* governance' (r = .461, p = 0.002); and '*Shari'ah* compliance' (r = .420, p = 0.005).

Table 5.41 also shows that 'Board composition' is highly correlated with 'Board leadership' (r = .943, p = 0.000); 'Nomination committee' (r = .838, p = 0.000); and 'Ethical business' (r = .759, p = 0.001) while its correlations are slightly above average with 'Board meeting' (r = .691, p = 0.004); '*Shari'ah* governance' (r = .656, p = 0.008); and '*Shari'ah* compliance' (r = .588, p = 0.021).

As indicated in Table 5.41, the 'Board leadership' is highly correlated with the 'Nomination committee' (r = .869, p = 0.000) and 'Ethical business' (r = .790, p = 0.000). The 'Board leadership' relationships are above average with '*Shari'ah* governance' (r = .669, p = 0.006); '*Shari'ah* compliance' (r = .669, p = 0.006) and 'Board meeting' (r = .507, p = 0.054).

It is also observed that the variable 'Nomination committee' is quite strongly correlated with '*Shari'ah* governance' (r = .697, p = 0.004); '*Shari'ah* compliance' (r = .688, p = 0.005) and slightly above average with 'Ethical business' (r = .599, p = 0.018),

As shown in Table 5.41, '*Shari'ah* governance' is highly correlated with '*Shari'ah* compliance' (r = .798, p = 0.000). The table below also indicates very modest relationship between '*Shari'ah* compliance' and 'Ethical business' (r = .505, p = 0.055).

Table 5.41: Correlation Estimations between CGI and Dimensions and between Dimensions at Country-Level

			CG	Mission	Board composition	Board leadership	Board meeting	Nomination committee	Shari'ah governance	Shari'ah compliance	Ethical business
Spearman's rho	CG	Cor. Coef	1.000	.806**	.962**	.950**	.595*	.897**	.732**	.680**	.822**
		Sig.		.000	.000	.000	.019	.000	.002	.005	.000
		N	15	15	15	15	15	15	15	15	15
	Mission	Cor. Coef	.806**	1.000	.873**	.760**	.793**	.597*	.461	.420	.742**
		Sig.	.000		.000	.001	.000	.019	.084	.119	.002
		N	15	15	15	15	15	15	15	15	15
	Board composition	Cor. Coef	.962**	.873**	1.000	.943**	.691**	.838**	.656**	.588*	.759**
		Sig.	.000	.000		.000	.004	.000	.008	.021	.001
		N	15	15	15	15	15	15	15	15	15
	Board leadership	Cor. Coef	.950**	.760**	.943**	1.000	.507	.869**	.669**	.669**	.790**
		Sig.	.000	.001	.000		.054	.000	.006	.006	.000
		N	15	15	15	15	15	15	15	15	15
	Board meeting	Cor. Coef	.595*	.793**	.691**	.507	1.000	.459	.438	.157	.464
		Sig.	.019	.000	.004	.054		.085	.103	.577	.082
		N	15	15	15	15	15	15	15	15	15
	Nomination committee	Cor. Coef	.897**	.597*	.838**	.869**	.459	1.000	.697**	.688**	.599*
		Sig.	.000	.019	.000	.000	.085		.004	.005	.018
		N	15	15	15	15	15	15	15	15	15
	Shari'ah governance	Cor. Coef	.732**	.461	.656**	.669**	.438	.697**	1.000	.798**	.483
		Sig.	.002	.084	.008	.006	.103	.004		.000	.068
		N	15	15	15	15	15	15	15	15	15
	Shari'ah compliance	Cor. Coef	.680**	.420	.588*	.669**	.157	.688**	.798**	1.000	.505
		Sig.	.005	.119	.021	.006	.577	.005	.000		.055
		N	15	15	15	15	15	15	15	15	15
	Ethical business	Cor. Coef	.822**	.742**	.759**	.790**	.464	.599*	.483	.505	1.000
		Sig.	.000	.002	.001	.000	.082	.018	.068	.055	
		N	15	15	15	15	15	15	15	15	15

Notes: **. Correlation is significant at the 0.01 level (2-tailed); *. Correlation is significant at the 0.05 level (2-tailed).

5.7.3. Correlations between Risk Management and its Dimensions

This section proceeds with the results of the findings of RM correlation as depicted in Table 5.42 and Table 5.43.

5.7.3.1. Correlations between RMI and dimensions at bank-level

The results in Table 5.42 show that there are positive correlations between RMI and its dimensions. The proxy of RMI has slightly above average correlations with 'Risk management control' (r = .684, p = 0.000); 'Risk management committee' (r = .676, p = 0.000) and 'Reporting' (r = .654, p = 0.000). However, it is observed that the correlation is just about moderate between RM and 'Credit risk' (r = .544, p = 0.000); 'Audit' (r = .540, p = 0.000); 'Market and liquidity risk' (r = .461, p = 0.001) and 'Other risk' (r = .421, p = 0.002).

Table 5.42 also shows the strength of the relationships between dimensions in the RM group. There are positive correlations between various RM dimensions. Based on the table, modest relationships are observed between RM and its dimensions. 'Audit' is not strongly correlated with 'Risk management control' (r = .465, p = 0.000); 'Risk management committee' (r = .449, p = 0.001); 'Reporting' (r = .434, p = 0.001) and 'Other risk' (r = .289, p = 0.036). As for the variable 'Risk management committee', Table 5.42 also indicates that it is correlated with 'Risk management control' (r = .688, p = 0.000); 'Reporting' (r = .590, p = 0.000); 'Credit risk' (r = .585, p = 0.000); 'Market & liquidity risk' (r = .522, p = 0.000) and 'Other risk' (r = .444, p = 0.001).

The table also indicates that ' Risk management control' has correlations with 'Credit risk' (r = .646, p = 0.000); 'Reporting' (r = .616, p = 0.000); 'Market & liquidity risk' (r = .558, p = 0.000) and 'Other risk' (r = .533, p = 0.000). As for 'Reporting', it has quite strong correlation with 'Credit risk' (r = .741, p = 0.000), 'Market & liquidity risk' (r = .650, p = 0.000) and 'Other risk' (r = .608, p = 0.000).

This is quite similar to 'Market & liquidity risk' which has strong, positive correlations with 'Credit risk' (r = .875, p = 0.000) and 'Other risk' (r = .729, p = 0.000). Table 5.42 also shows that 'Credit risk' has a strong, positive correlation with 'Other risk' (r = .842, p = 0.000).

Table 5.42: Correlation Estimations between RMI and Dimensions and between Dimensions at Bank-Level

			RM	Audit	Risk management committee	Risk management control	Reporting	Market & liquidity risk	Credit risk	Other risks
Spearman's rho	RM	Cor.Coef	1.000	.540**	.676**	.684**	.654**	.461**	.544**	.421**
		Sig.		.000	.000	.000	.000	.001	.000	.002
		N	53	53	53	53	53	53	53	53
	Audit	Cor.Coef	.540**	1.000	.449**	.465**	.434**	.105	.200	.289*
		Sig.	.000		.001	.000	.001	.454	.151	.036
		N	53	53	53	53	53	53	53	53
	Risk management committee	Cor.Coef	.676**	.449**	1.000	.688**	.590**	.522**	.585**	.444**
		Sig.	.000	.001		.000	.000	.000	.000	.001
		N	53	53	53	53	53	53	53	53
	Risk management control	Cor.Coef	.684**	.465**	.688**	1.000	.616**	.558**	.646**	.533**
		Sig.	.000	.000	.000		.000	.000	.000	.000
		N	53	53	53	53	53	53	53	53
	Reporting	Cor.Coef	.654**	.434**	.590**	.616**	1.000	.650**	.741**	.608**
		Sig.	.000	.001	.000	.000		.000	.000	.000
		N	53	53	53	53	53	53	53	53
	Market & liquidity risk	Cor.Coef	.461**	.105	.522**	.558**	.650**	1.000	.875**	.729**
		Sig.	.001	.454	.000	.000	.000		.000	.000
		N	53	53	53	53	53	53	53	53
	Credit risk	Cor.Coef	.544**	.200	.585**	.646**	.741**	.875**	1.000	.842**
		Sig.	.000	.151	.000	.000	.000	.000		.000
		N	53	53	53	53	53	53	53	53
	Other risks	Cor.Coef	.421**	.289*	.444**	.533**	.608**	.729**	.842**	1.000
		Sig.	.002	.036	.001	.000	.000	.000	.000	
		N	53	53	53	53	53	53	53	53

Notes: **. Correlation is significant at the 0.01 level (2-tailed); *. Correlation is significant at the 0.05 level (2-tailed).

5.7.3.2. Correlations between RMI and dimensions at country-level

The correlation estimates in Table 5.43 show positive correlations between risk management and its dimensions. The RM has strong, positive correlations with 'Risk management control' (r = .928, p = 0.000); 'Reporting' (r = .905, p = 0.000); 'Risk management committee' (r = .878, p = 0.000) and 'Other risk' (r = .714, p = 0.003). The RM also has slightly above average correlations with 'Credit risk' (r = .680, p = 0.005); 'Audit' (r = .668, p = 0.006) and 'Market & liquidity risk' (r = .644, p = 0.010).

Table 5.43 also shows the relationships between the RMI dimensions. It is noted that 'Audit' has positive correlations with 'Risk management committee' (r = .710, p =

0.003); 'Risk management control' (r = .561, p = 0.030) and 'Reporting' (r = .524, p = 0.045). Based on Table 5.43, the variable 'Risk management committee' is correlated with 'Reporting' (r = .843, p = 0.000); 'Risk management control' (r = .799, p = 0.000); 'Other risk' (r = .530, p = 0.042) and 'Credit risk' (r = .522, p = 0.046).

Table 5.43: Correlation Estimations between RMI and Dimensions and between Dimensions at Country Level

			RM	Audit	Risk management committee	Risk management control	Reporting	Market & Liquidity risk	Credit risk	Other risks
Spearman's rho	RM	Cor.Coef	1.000	.668**	.878**	.928**	.905**	.644**	.680**	.714**
		Sig.		.006	.000	.000	.000	.010	.005	.003
		N	15	15	15	15	15	15	15	15
	Audit	Cor.Coef	.668**	1.000	.710**	.561*	.524*	.116	.109	.254
		Sig.	.006		.003	.030	.045	.680	.699	.360
		N	15	15	15	15	15	15	15	15
	Risk management committee	Cor.Coef	.878**	.710**	1.000	.799**	.843**	.460	.522*	.530*
		Sig.	.000	.003		.000	.000	.084	.046	.042
		N	15	15	15	15	15	15	15	15
	Risk management control	Cor.Coef	.928**	.561*	.799**	1.000	.767**	.640*	.663**	.614*
		Sig.	.000	.030	.000		.001	.010	.007	.015
		N	15	15	15	15	15	15	15	15
	Reporting	Cor.Coef	.905**	.524*	.843**	.767**	1.000	.622*	.686**	.664**
		Sig.	.000	.045	.000	.001		.013	.005	.007
		N	15	15	15	15	15	15	15	15
	Market & Liquidityrisk	Cor.Coef	.644**	.116	.460	.640*	.622*	1.000	.962**	.925**
		Sig.	.010	.680	.084	.010	.013		.000	.000
		N	15	15	15	15	15	15	15	15
	Credit risk	Cor.Coef	.680**	.109	.522*	.663**	.686**	.962**	1.000	.914**
		Sig.	.005	.699	.046	.007	.005	.000		.000
		N	15	15	15	15	15	15	15	15
	Other risks	Cor.Coef	.714**	.254	.530*	.614*	.664**	.925**	.914**	1.000
		Sig.	.003	.360	.042	.015	.007	.000	.000	
		N	15	15	15	15	15	15	15	15

Notes: **. Correlation is significant at the 0.01 level (2-tailed); *. Correlation is significant at the 0.05 level (2-tailed).

Table 5.43 also shows that 'Risk management control' has positive correlations with 'Reporting' (r = .767, p = 0.001); 'Credit risk' (r = .663, p = 0.007); 'Market & liquidity risk' (r = .640, p = 0.010) and 'Other risk' (r = .614, p = 0.015). The variable 'Reporting' has moderate positive correlations with 'Credit risk' (r = .686, p = 0.005); 'Other risk' (r = .664, p = 0.007) and 'Market & liquidity risk'(r = .622, p = 0.013).

As indicated in Table 5.43, 'Market & liquidity risk' has very strong positive correlations with 'Credit risk' (r = .962, p = 0.000) as well as 'Other risk' (r = .925, p = 0.000). As for the 'Credit risk', it has a very strong positive correlation with 'other risk' (r = .914, p = 0.000).

5.7.4. Summary of the Relationship between CGI and RMI

The analysis in this section shows all the possible relationships between CGI and RMI based on correlation analysis that is employed on data for both bank and country comparisons. It is observed that the strength of the relationship between CG and RM is just slightly above average. It is also noted that some of the dimensions of CG and RM have very strong relationships with each other. Perhaps this could be the reason why in many instances, CG and RM seem to be discussed interchangeably.

The correlation analysis in this section is aimed at examining the relationships among the dimensions (*i.e.* two dimensions at a time), based on the respective CG and RM frameworks. The analysis is pursued to further investigate the inter-relationship between CG and RM. This is carried out through a regression analysis in the following section.

5.8. EXPLORING THE IMPACT OF DIMENSIONS ON CGI AND RMI: REGRESSION ANALYSIS

In identifying which variables have a greater effect on the dependent variable with the objective of both substantiating the findings from descriptive and correlation analyses so far present, a further investigation of the inter-relationship between CG and RM is carried out through regression analysis. It should be noted that regression analysis as a statistical method is about describing and evaluating the relationship between a given variable and one (or more) variables to explain movements in a variable by reference to movements in other variables (Gravetter and Wallnau, 2008).

This section aims to find out the effect of each dimension of CGI through regression analysis. Similarly, the same approach applies in finding the effects on RMI. The findings are based on the test conducted on the banks comparison.

The following regression model is formulated by taking the dimensions of CG as the independent variables to explain the dependent variable, CGI.

$$CG = \alpha_1 + \beta_1 mission + \beta_2 boardcomposition + \beta_3 boardleadership + \beta_4 boardmeeting + \beta_5 nominationcommittee + \beta_6 shariahgov + \beta_7 shariahcompliance + \beta_8 ethicalbusiness + \varepsilon_1 \quad (1)$$

Based on the proposed model, there are 8 dimensions that determine the CGI score. Similarly, a regression model is formulated where RMI is regressed against its dimensions as shown in the regression equation 2:

$$RM = \alpha_2 + \beta_1 riskmgtcommittee + \beta_2 riskmgtpractice + \beta_3 riskmtdisclosure + \beta_4 reporting + \beta_5 marketliqrisk + \beta_6 creditrisk + \beta_7 otherrisks + \beta_8 ethicalbusiness + \varepsilon_2 \quad (2)$$

where *CG*: corporate governance; *RM*: risk management; α_1 and α_2 are constants; ε_1 and ε_2 = error terms.

The models use CGI and RMI as the respective dependent variables, while their respective dimensions are the independent variables. Based on the equation 1, CG is a function of CG's dimensions (which are the explanatory variables).

5.8.1. Regression Results for CGI

This section employs a multiple regression analysis to measure the determinants of CGI through the secondary data obtained from the annual reports.

Table 5.44: Model Summary of the Regression Analysis for CG for IBs

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.883[a]	.780	.740	.113608

Notes: a. Predictors: (Constant), ethicalbusiness, boardmeeting, *Shari'ah*governance, *Shari'ah*compliance, boardleadership, nominationcommittee, mission, boardcomposition

Based on the model summary (Table 5.44), the adjusted R-Square or the coefficient of determination is quite close to the perfect model with about 74%. Thus, the model

presented in this study explains about 74% of the variations observed in the dependent variable, which is quite highly satisfactory.

The result of the adjusted R^2 is verified by the results provided through ANOVA (Table 5.45), as dividing the regression sum of squares by the total sum of squares, the same adjusted *R* result is obtained.

Table 5.45: ANOVA[a] for CG for IBs

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.010	8	.251	19.471	.000[b]
	Residual	.568	44	.013		
	Total	2.578	52			

Notes: a. Dependent Variable: cg; b. Predictors: (Constant), ethicalbusiness, boardmeeting, *Shari'ah*governance, *Shari'ah*compliance, boardleadership, nominationcommittee, mission, boardcomposition

Table 5.45 also indicates that ANOVA analysis produced highly significant results as the models were fully significant.

Table 5.46: Regression Coefficient for CG for IBs

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	.026	.036		.725	.472
	Mission	.060	.101	.091	.596	.555
	Boardcomposition	.188	.141	.285	1.332	.190
	Boardleadership	-.002	.075	-.003	-.022	.983
	Boardmeeting	.075	.061	.133	1.220	.229
	Nominationcommittee	.032	.083	.053	.385	.702
	*Shari'ah*governance	.167	.099	.174	1.691	.098
	Shariahcompliance	.335	.094	.360	3.559	.001
	ethicalbusiness	.067	.100	.079	.673	.504

Note: a. Dependent Variable: CG

Table 5.46 provides the coefficient estimates for the models mentioned through the path analysis by using the multiple linear regression method. As depicted, the model has only one dimension, '*Shari'ah* compliance' with a coefficient value of 36.0 and *p*-value of 0.001, which is found to be statistically significant. Indeed '*Shari'ah*

governance' is also found to be statistically significant at the 10% level of significance. The remaining dimensions: 'mission', 'board composition', 'board leadership', 'board meeting', 'nomination and remuneration committee' and 'ethical business' were found to be not statistically significant based on the analysis. Having '*Shari'ah* governance' statistically significant is indeed an important conclusion for IBs.

5.8.2. Regression Results for RM

Similarly, the study measured determining variables of RMI through the same set of secondary data by employing the multiple regression analysis. Table 5.47 provides a model summary where the adjusted R^2 or the coefficient of determination was quite close to the perfect model with about 69%. Thus, the model presented in this study explains about 69% of the variation observed in the dependent variable, which is quite highly satisfactory.

Table 5.47: Model Summary of the regression analysis for RM for IBs

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.855[a]	.731	.689	.127805

Notes: a. Predictors: (Constant), otherrisks, audit, riskmgtcommittee, reporting, riskmgtcontrol, marketliqrisk, creditrisk

The result of the adjusted R^2 is verified by the results provided through ANOVA as shown in Table 5.48, as by dividing the regression sum of squares by the total sum of squares, the same adjusted *R* result is obtained. The table indicates that ANOVA analysis produced highly significant results as the models were fully significant.

Table 5.48: ANOVA[a] for RM for IBs

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.993	7	.285	17.431	.000[b]
	Residual	.735	45	.016		
	Total	2.728	52			

Notes: a. Dependent Variable: rm; b. Predictors: (Constant), otherrisks, audit, riskmgtcommittee, reporting, riskmgtcontrol, marketliqrisk, creditrisk

Table 5.49 provides the coefficient estimates for the models mentioned through the path analysis by using the multiple linear regression method. As depicted, the model has only two dimensions: 'reporting' and 'risk management control' with both variables being statically significant with a coefficient value of 0.52 with *p*-value of 0.001, and 0.31 with *p*-value of 0.027. The remaining dimensions: 'audit', 'risk management committee', 'risk management control', market and liquidity risk', 'credit risk' and 'other risks' are not significant based on the analysis. It should be noted that 'market and liquidity risks' and 'credit risk' variables are not statistically significant but they do have a negative relationship with the dependent variable. As the results show, 'reporting' and 'risk management control', being significant among other variables, makes sense considering the importance of such variables in the RM process.

Table 5.49: Regression Coefficient for RM for IBs

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	.097	.058		1.667	.102	-.020	.214
	audit	.142	.110	.130	1.299	.201	-.078	.363
	riskmgtcommittee	.071	.073	.120	.962	.341	-.077	.219
	riskmgtcontrol	.203	.088	.312	2.291	.027	.025	.381
	reporting	.396	.108	.520	3.668	.001	.179	.614
	marketliqrisk	-.059	.118	-.090	-.504	.617	-.296	.178
	creditrisk	-.018	.168	-.025	-.105	.917	-.356	.321
	otherrisks	.016	.130	.021	.121	.904	-.247	.278

Note: a. Dependent Variable: rm

5.9. CONCLUSION

This chapter presented extensive analysis in various levels and through various methods in determining CGI and RMI and also the correlation within and between themselves. The analysis is concluded with a regression analysis in an attempt to determine the most effective dimension having impact on CGI and RMI respectively.

The findings in this chapter show that all the CG dimensions have positive effects on CG apart from board leadership, which has a negative effect. However, only two

variables have significant effects on CGI: *Shari'ah* governance' (at the 10% significance level) and '*Shari'ah* compliance' (at the 5% significance level). As for RM, all their dimensions have a positive effect on RM apart from 'market risk' and 'credit risk', which have a negative effect. Similar to CGI, only two variables have significant effects on RMI: 'reporting' and 'risk management control', at the 5% significance level. The findings confirm the hypotheses which state that '*Shari'ah* compliance' and '*Shari'ah* governance' are the key determinants of CGI while 'reporting' and 'risk management control' are the key factors in risk management.

Further reflections on the descriptive analysis showing low CGI and RMI are also provided in this chapter, which should be a cause of concern for the robust and consolidated development of the IBs.

CHAPTER 6

UNDERSTANDING PERCEPTIONS ON CORPORATE GOVERNANCE AND RISK MANAGEMENT: DESCRIPTIVE FINDINGS FROM THE QUESTIONNAIRE SURVEY

6.1. INTRODUCTION

This chapter presents the findings from a questionnaire survey conducted on corporate governance and risk management with managers from Islamic banks in a number of countries. In undertaking the survey, questionnaires were used as a medium to reach the Islamic Banks' (IBs) employees. The information obtained from the respondents is used to gauge their perceptions on corporate governance frameworks and risk management aspects in IBs through developed categories in an attempt to explore the relationship between Corporate Governance (CG) and Risk Management (RM).

As explained in research methodology chapter, this study assumes that CG and RM are two separate frameworks. Thus, the questionnaire is divided into two main parts: 'corporate governance' and 'risk management', each part has 66 and 57 constructs respectively. The CG and RM segment is separated into six and five dimensions respectively. The six corporate governance dimensions are: 'board', 'structure, committee and senior management', 'disclosure and transparency', 'audit', 'policies and procedures' and 'supports and operations'. The 5 dimensions of RM are: 'risk management (general)', 'credit risk', 'market and liquidity risks', 'operational risk', and '*Shari'ah* risk'.

Each statement of CG and RM is a construct (also known as a variable) that is measured individually. Subsequently, the related constructs are measured collectively through their respective dimensions.

SPSS is employed to analyse each construct by running a frequency test. The results are in the form of statistically empirical evidence which display the mean score of each dimension obtained based on the level of perception indicated by the

respondents. Using the SPSS generated output, the results are presented in a series of simplified tables below.

One of the ways this research provides information about the data is through a descriptive analysis, which aims to describe the main features of the data quantitatively. As its preliminary findings, this chapter provides a descriptive analysis using SPSS[44]. In addition, inferential statistical analyses in the form of parametric tests are also presented.

This chapter is comprised of seven sections: the first section covers the demographic profiles of the respondents and provides a descriptive analysis of the profiles. In line with the format of the questionnaire, the second and third sections deal with CG-related and RM-related constructs respectively. The fourth section presents a summary of the descriptive analysis while the fifth section highlights the criteria that influences the perceptions. Section six and seven both present the statistical analysis before the chapter concludes with the findings of its perception approach.

6.2. THE DEMOGRAPHIC PROFILE OF THE PARTICIPANTS

This section presents the demographic profiles of the participants of the survey. The questionnaire is aimed at getting responses from Islamic banks (IB) from all over the world. To maintain confidentiality, the questionnaire only requires four types of details from the respondents, which are the: locality of the IB, position of the respondent, nature of the IB, and the inception year of the IB.

The findings of the demographic profile provided through the SPSS-based analysis are presented in the simplified Table 6.1. As can be seen from the table, 39.3% of the responses obtained are from Indonesia, while 28.6% are from Malaysia, 14.3% are from Turkey, and 10.7% are from the UK. Qatar and Pakistan provide 3.6% of the responses, respectively. Questionnaires were initially targeted to reach Islamic banks in any part of the world. However, this was not achieved as getting responses from IBs was the biggest hurdle in the research process, and therefore the sampled IBs remained limited with six countries and 28 IBs.

[44] SPSS is used to provide the characteristics of the variables in the data file as it provides a quick summary of the data (Pallant, 2010) in which details such as frequencies and mean values are ranked to be used for further analysis.

As depicted in Table 6.1, 42.9% of the responses obtained are from risk-related officers while 50% are from non-risk-related officers. The remaining 7.1% of the respondents did not specify their positions. Perhaps this suggests a preference for confidentiality, and may be associated with the poor response rate for the questionnaire.

Table 6.1: Demographic Profile of the Sampled Institutions

Variable Group	Variable	Valid Frequency	Percentage Valid
Location	Indonesia	11	39.3
	Malaysia	8	28.6
	Pakistan	1	3.6
	Qatar	1	3.6
	Turkey	4	14.3
	UK	3	10.7
	Total	28	100.0
Position	Risk Officer	12	42.9
	Non-risk officer	14	50.0
	Not specified	2	7.1
	Total	28	100.0
Type	Full-fledged Islamic Bank	22	78.6
	Islamic window of conventional domestic bank	4	14.3
	Islamic financial institution	1	3.6
	Islamic window of conventional foreign bank	1	3.6
	Total	28	100.0
Year	Before 1990s	4	14.3
	1990s	5	17.9
	Between 2000 to 2006	10	35.7
	2007-2012	8	28.6
	Not specified	1	3.6
	Total	28	100.0

Despite its aims to reach IBs from five categories, based on Table 6.1, only four categories of IBs responded to the survey. About 78.6% of the responses are from ‘full-fledged Islamic bank’, while 14.3% are from ‘Islamic window of domestic conventional bank’. The responses from the ‘Islamic financial institution’ and

'Islamic window of foreign conventional bank' account for 3.6% each. As the results show, no responses from any of the 'foreign Islamic bank' could be gathered.

In examining the relationship between Corporate Governance (CG) and Risk Management (RM) practices in IBs, the developments of CG and RM in IBs are associated with the duration or longevity of their presence in the industry. Thus, based on their inception or establishment years, the IBs are grouped into four phases: 'before 1990s', 'during 1990s', 'between 2000 to 2006' and 'between 2007 to 2012'. As shown in Table 6.1, 35.7% of the responses are from IBs established 'between 2000 to 2006' and 28.6% are from the banks established 'between 2007 to 2012'. Responses from the IBs established 'during 1990s' and 'before 1990s' account for 17.9% and 14.3% respectively. The remaining 3.6% of the responses (1) come from IBs, which did not state their inception year.

6.3. PERCEPTIONS ON CORPORATE GOVERNANCE

This section presents the findings on CG-related issues as covered in the questionnaire. It constitutes all the essential parts (dimensions) of CG which are presented on each individual construct of the CG dimensions based on the perceptions of the respondents.

6.3.1. Perceptions on Board's Effectiveness

Table 6.2 presents the results on 'board effectiveness' based on perceptions through 16 constructs as well as from the fact-finding gathered from the first construct of this dimension.

Unlike the rest of the constructs, the first construct is aimed at fact finding and is not about perception. This statement establishes whether 'the roles of the chairman and CEO are split'. Quite often, the functions of the Chairman and CEO are normally held by two different individuals.

Table 6.2: Perceptions on Board Effectiveness

Construct		Frequency (valid)	Valid %	Mean	Mean Ranking	Standard Deviation
Roles of Chairman and CEO split	Yes	24	88.9	1.11	17	0.32
	No	3	11.1			
	Total	27	100			
The bank has appropriate number of independent DIRs	Strongly Disagree	2	7.1	3.96	12	1.20
	Disagree	2	7.1			
	Neutral	2	7.1			
	Agree	11	39.3			
	Strongly Agree	11	39.3			
	Total	28	100			
The Board is not over-powered by the Chairman	Strongly Disagree	1	3.6	3.64	15	1.13
	Disagree	5	17.9			
	Neutral	3	10.7			
	Agree	13	46.4			
	Strongly Agree	6	21.4			
	Total	28	100			
The Board provides adequate oversight	Disagree	1	3.6	4.00	10	0.82
	Neutral	6	21.4			
	Agree	13	46.4			
	Strongly Agree	8	28.6			
	Total	28	100			
The Board has clear mission and vision	Strongly Disagree	1	3.6	4.04	7	0.92
	Disagree	1	3.6			
	Neutral	2	7.1			
	Agree	16	57.1			
	Strongly Agree	8	28.6			
	Total	28	100			
The Board has diverse background and expertise	Disagree	1	3.6	4.07	5	0.66
	Neutral	2	7.1			
	Agree	19	67.9			
	Strongly Agree	6	21.4			
	Total	28	100			
The Board has strong credentials	Disagree	3	10.7	4.04	7	0.88
	Neutral	1	3.6			
	Agree	16	57.1			

Construct		Frequency (valid)	Valid %	Mean	Mean Ranking	Standard Deviation
	Strongly Agree	8	28.6			
	Total	28	100			
The Board is ethical and transparent	Strongly Disagree	1	3.6	4.07	5	0.94
	Disagree	1	3.6			
	Neutral	2	7.1			
	Agree	15	53.6			
	Strongly Agree	9	32.1			
	Total	28	100			
The Board oversees strategic planning process	Disagree	1	3.6	4.14	4	0.71
	Neutral	2	7.1			
	Agree	17	60.7			
	Strongly Agree	8	28.6			
	Total	28	100			
The Board monitors management's execution plan	Neutral	1	3.6	4.39	1	0.57
	Agree	15	53.6			
	Strongly Agree	12	42.9			
	Total	28	100			
The Board reviews management code of conduct	Disagree	1	3.6	4.00	10	0.72
	Neutral	4	14.3			
	Agree	17	60.7			
	Strongly Agree	6	21.4			
	Total	28	100			
The Board assess resources and prioritises key operational matters	Disagree	3	10.7	3.75	13	0.89
	Neutral	6	21.4			
	Agree	14	50.0			
	Strongly Agree	5	17.9			
	Total	28	100			
The Board ascertains no misleading financial statements	Disagree	1	3.7	4.19	3	0.68
	Neutral	1	3.7			
	Agree	17	63.0			
	Strongly Agree	8	29.6			
	Total	27	100			
The Board has effective succession planning	Strongly Disagree	1	3.6	3.43	16	1.00
	Disagree	4	14.3			

Construct		Frequency (valid)	Valid %	Mean	Mean Ranking	Standard Deviation
	Neutral	8	28.6			
	Agree	12	42.9			
	Strongly Agree	3	10.7			
	Total	28	100			
The Board convenes effective meeting	Disagree	2	7.1	4.29	2	0.85
	Neutral	1	3.6			
	Agree	12	42.9			
	Strongly Agree	13	46.4			
	Total	28	100			
The Board adopts effective approvals on decision-making	Disagree	1	3.6	4.04	7	0.79
	Neutral	5	17.9			
	Agree	14	50.0			
	Strongly Agree	8	28.6			
	Total	28	100			
The Board recognises the needs in light of technological change	Strongly Disagree	1	3.6	3.75	13	0.97
	Disagree	1	3.6			
	Neutral	8	28.6			
	Agree	12	42.9			
	Strongly Agree	6	21.4			
	Total	28	100			

According to the responses obtained in Table 6.2, 88.9% of the IBs have split roles for the Chairman and CEO, signifying the IBs' preferences for having two individuals for the two separate positions. This may indicate that this structure is probably preferred because it is assumed that it is more effective and works better for addressing issues on transparency, conflict of interest, and control, at the very least. On the other hand, 11.1% of the IBs show that the Chairman and the CEO have dual functions (*i.e.* the position is held by the same individual), and one bank does not reveal whether it has separate roles and functions for its Chairman and CEO positions.

As shown in Table 6.2, 39.3% of the respondents agree that their banks have an 'appropriate number of independent directors' sitting on the board. Similar

percentages account for the ones who strongly agree with the statement. This implies that the boards of the IBs have adequate independence in decision making. Having the right number of independent directors sitting in the board accentuates the assurance of board independence in the decision making process. Nevertheless, a small percentage of the respondents perceive the issue differently. Those who disagree, strongly disagree, and are neutral with this statement each represent 7.1% of the respondents respectively.

Despite many general claims that banks are always overpowered by their Chairman, 67.8% of the respondents agree that 'the board is not over-powered by the chairman'. In fact, 21.4% of the respondents strongly assert this point. This may suggest that the board bench has the strength and additional power to challenge the CEO. However, 21.5% feel that the banks are over-powered by the Chairman and another 3.6% strongly agree with this. The remaining 10.7% of the respondents remain indifferent.

Boards that help to formulate and develop plans could help strategise the banks better. Based on the findings presented in Table 6.2, 75% of the respondents agree that their boards 'provide adequate oversight function' while 28.6% of them strongly believe that the board has the oversight capability attributed to their holistic view. However 3.6% of the respondents disagree with that statement while 21.4% of the respondents do not indicate their views on this.

As seen in Table 6.2, 57.1% of the respondents agree that the board has 'clear missions and vision' for the bank and another 28.6% of them strongly agree with this point. This implies that the bank is effectively transparent and it communicates well across the board. This could be reflected in the projects or any initiatives undertaken by the bank. While 7.1% of the respondents are indifferent, the group that disagree and strongly disagree pertaining to the board having a clear mission and vision make up 3.6% of respondents.

The board may have diverse backgrounds and skill sets which help to weigh and challenge the CEO's opinion. In exploring such issues, Table 6.2 shows that 67.9% and 21.4% of the respondents agree and strongly agree respectively that their 'board have the diverse background and expertise to steer the bank'. This implies that the banks have a prudent nomination committee that is capable of bringing in good talent

and highly competent people to sit in the board to lead the bank. However 3.6% of the respondents disagree with this point while another 7.1% of the respondents remain neutral.

Based on Table 6.2, 57.1% and 28.6% of the respondents agree and strongly agree that the board 'have strong credentials' in their IBs, which implies that the board has a strong presence in the bank where their experiences and past successes have contributed towards the bank's performance. About 10.7% of the respondents disagreeing with this perception may be because of inadequate directions being given to management. Another 3.6% however, are indifferent on this issue.

Boards are always held responsible in ensuring that all aspects of work are undertaken in a credible manner worthy of public trust and confidence. This is reflected in the bank survey as, based on Table 6.2, 53.6% of the respondents assert that the board is 'ethical and transparent' and another 32.1% strongly share this view. This may imply that the banks contain a board that has a high regard for their duty of care and obligation. However those who disagree and strongly disagree make up 3.6% of the respondents each, and this could be due to unfavourable changes in the banks' policies that the banks implement. Another 7.1% of them are neutral.

As shown in Table 6.2, 60.7% of the respondents think that the board 'oversee the strategic planning process' of the bank and another 28.6% strongly agree on this. The results suggest that the banks have a competent board that has a clear sense of direction with holistic views and varying perspectives. Nevertheless, 3.6% of the respondents do not agree that their board is involved in strategic planning while another 7.1% of the respondents are indifferent with the statement.

As indicated in Table 6.2, 53.6% of the respondents agree that the board 'monitor the management's execution of the corporate and business plan', while another 42.9% strongly agree with this point. This may imply that the board addresses issues in the bank by being observant with the developments in the bank and how the management functions while segregating their workloads to ensure timely and consistent decision making at the appropriate level. To a certain extent, the monitoring is reflected via board meetings. About 3.6% of the respondents are neutral on this point. There is no perceived disagreement on this statement.

Based on the findings presented in Table 6.2, 60.7% of respondents agree that the board 'reviews the codes of conduct and ethics that are incorporated into the bank's strategy and business operations with the management' and another 21.4% of the respondents strongly agree with this point. This implies that the bank ascertains work ethics from the top to ensure credibility and its worthiness of using resources efficiently and effectively to avoid improper use of public funds. Those who disagree with this statement make up 3.6% of the respondents while the remaining 14.3% of them are indifferent.

As shown in Table 6.2, 50% of the respondents agree that the board 'assess resources and prioritises key operational matters of the bank' and another 17.9% of the respondents strongly agree with this point. This suggests that the banks have a smooth implementation in their undertaken projects as the board themselves are involved by making sure that the bank has adequate resources and uses them objectively. However 10.7% of the respondents disagree that the board is involved in the assessment of the operational process at all. The remaining 21.4% of the respondents indicate their neutral perception.

As depicted in Table 6.2, 63% and 29.6% of the respondents agree and strongly agree respectively that the board 'ascertains that there are no misleading financial statements'. This implies that the banks have no issues with complying with the laws and regulations, while none of the respondents have very strong disagreements with this, and 3.7% of the respondents indicate disagreement. This could be due to the absence of a statement which shows that the board undertakes the validity of the financial statement. It should be noted that 3.7% of the respondents remain neutral.

Monitoring and assessing performance is part of the board's responsibilities. Based on Table 6.2, 42.9% of the respondents agree that 'the board has effective succession planning with well-articulated assessment and benchmarking strategy to help decide on the future leader'. Another 10.7% strongly agree with this view. This implies that the sampled banks have good training programmes to support succession planning. However, 14.3% of the respondents disagree that the board has effective succession planning in place and another 3.6% strongly disagree on this point. This could be triggered by many factors such as: too many independent board members sitting in the board and not being fully engaged with the bank or inadequate information being fed

to the board. Unsuitable structures or committees in charge of succession planning can also contribute to disagreement on this construct. The remaining 28.6% of the respondents are neutral.

As shown in Table 6.2, 46.4% of the respondents strongly agree that the 'board convenes its regular meetings effectively' and 42.9% agree with this. This suggests that the banks have proper monitoring and documentation processes as far as board meetings are concerned. The agenda and minutes of the board meetings reveal the effectiveness of the meeting through an adequate record of the details. However, 7.1% of the respondents disagree with the board meetings' effectiveness, while another 3.6% of the respondents remain neutral. None of the respondents show strong disapproval on this point.

When the banks are well acquainted with the dynamics of the decision-making process and are receptive to challenges and new models in the environment, it implies that an effective system is in place. Based on Table 6.2, 50% of the respondents agree that 'the board adopts an effective system on their approvals on decision-making' process. In addition, about 28.6% of the respondents strongly agree with the statement. However 3.6% of the respondents disagree that the board adopts an effective system and the remaining 17.9% of the respondents are indifferent.

Despite technology being woven into every aspect of the banking business, some still view that understanding IT is primarily the job of the IT officers. However, as the findings demonstrated in Table 6.2 show, 42.9% of the respondents assert that 'the board recognises the need to develop and strengthen their governance skills in light of technological developments and changing environments to become better leaders and change agents', while 21.4% strongly agree with this. It should be added that those who disagree and have very strong disagreement on the board recognising such a need make up 3.6% of the respondents each. Another 28.6% of the respondents remain neutral.

6.3.2. Perceptions on the Appropriateness of the Structure and Committees and Effectiveness of the Senior Management

Table 6.3 presents the results on the constructs of the second dimension, namely on the appropriateness and effectiveness of the structure, committees, and the senior management of the IBs based on the 15 constructs from the sampled respondents.

Based on Table 6.3, 60.7% of the respondents agree that the bank has 'an appropriate structure in place to assist in discharging its functions', while the remaining 39.3% are in strong agreement with this. There are no disagreements or neutral opinions on the statement, which implies that the banks have appropriate and adequate structures and committees as well as good senior management support to share insights with the board in addressing governance challenges. This eases the job towards complying with the regulations and achieving the bank's expectations.

As regards to the construct that 'the bank has clear reporting line as reflected in the organisational chart', as the findings in Table 6.3 shows, 67.9% of the respondents agree and 28.6% of them strongly agree with the reporting. This implies that the banks under survey have a very transparent organisational structure. Another 3.6% of the respondents remain neutral and no disagreements were recorded.

Table 6.3 also indicates that the respondents who agree and strongly agree on the statement that '*Shari'ah* advisors are impartial and independent of the bank' account for 42.9% each. This suggests that the banks have a proper and clear mandate with regards to their expectations of the appointed *Shari'ah* advisors. However, 10.7% of them disagree with this while 3.6% of the respondents remain neutral. None of the respondents indicate strong disagreement on this statement.

Table 6.3: Perceptions on the Appropriateness of the Structure and Committees and Effectiveness of the Senior Management

Construct		Frequency (valid)	Percent (valid)	Mean	Mean Ranking	Standard Deviation
Appropriate structure to assist Board discharging its function is in place	Agree	17	60.7	4.39	1	0.50
	Strongly Agree	11	39.3			
	Total	28	100			
The bank has clear reporting line	Neutral	1	3.6	4.25	4	0.52
	Agree	19	67.9			
	Strongly Agree	8	28.6			
	Total	28	100			
Shari'ah advisors are impartial	Disagree	3	10.7	4.18	6	0.94
	Neutral	1	3.6			
	Agree	12	42.9			
	Strongly Agree	12	42.9			
	Total	28	100			
Shari'ah advisors are resourceful and efficient	Disagree	1	3.6	3.86	11	0.80
	Neutral	8	28.6			
	Agree	13	46.4			
	Strongly Agree	6	21.4			
	Total	28	100			
Shari'ah advisors are easily accessible	Disagree	2	7.1	3.93	10	0.86
	Neutral	5	17.9			
	Agree	14	50			
	Strongly Agree	7	25			
	Total	28	100			
Shari'ah advisors have appropriate skill sets and experience	Neutral	4	14.8	4.26	3	0.71
	Agree	12	44.4			
	Strongly Agree	11	40.7			
	Total	27	100			
Shari'ah advisor ensure contracts, fatwa, executions and policies comply with *Shari'ah*	Neutral	1	3.6	4.32	2	0.55
	Agree	17	60.7			
	Strongly Agree	10	35.7			

Construct		Frequency (valid)	Percent (valid)	Mean	Mean Ranking	Standard Deviation
	Total	28	100			
Shari'ah advisors monitor business to safeguard shareholders' interests	Strongly Disagree	1	3.6	3.54	13	1.10
	Disagree	4	14.3			
	Neutral	8	28.6			
	Agree	9	32.1			
	Strongly Agree	6	21.4			
	Total	28	100			
Shari'ah advisors ascertain internal controls and operations of bank's conduct	Strongly Disagree	2	7.1	3.43	15	1.20
	Disagree	5	17.9			
	Neutral	5	17.9			
	Agree	11	39.3			
	Strongly Agree	5	17.9			
	Total	28	100			
Shari'ah advisors ensure adequacy of compliance with legal and regulatory requirements	Strongly Disagree	2	7.1	3.54	13	1.07
	Disagree	3	10.7			
	Neutral	4	14.3			
	Agree	16	57.1			
	Strongly Agree	3	10.7			
	Total	28	100			
Shari'ah advisors perform product approval	Strongly Disagree	1	3.6	3.96	9	1.04
	Disagree	2	7.1			
	Neutral	3	10.7			
	Agree	13	46.4			
	Strongly Agree	9	32.1			
	Total	28	100			
Bank has competent senior management	Disagree	2	7.1	4.11	7	0.83
	Neutral	2	7.1			
	Agree	15	53.6			
	Strongly Agree	9	32.1			
	Total	28	100			
The senior management develops strategic plans	Disagree	3	10.7	4.07	8	0.90
	Neutral	1	3.6			

Construct		Frequency (valid)	Percent (valid)	Mean	Mean Ranking	Standard Deviation
for board review	Agree	15	53.6			
	Strongly Agree	9	32.1			
	Total	28	100			
The senior management oversees enforcement on policy implementation	Disagree	1	3.6	4.21	5	0.74
	Neutral	2	7.1			
	Agree	15	53.6			
	Strongly Agree	10	35.7			
	Total	28	100			
The senior management articulates the bank's missions and vision effectively to all staff	Disagree	2	7.1	3.82	12	0.90
	Neutral	8	28.6			
	Agree	11	39.3			
	Strongly Agree	7	25			
	Total	28	100			

It should be noted that the string agreement in favour of the statement that '*Shari'ah* advisors are impartial and independent of the bank' should be interpreted with caution as it is the interest of the IBs to portray such a picture. However, while the *Shari'ah* scholars are selected and paid directly by the IBs, it is difficult to talk about their impartiality and independence.

Regarding the construct that '*Shari'ah* advisors are resourceful and efficient', as the results in Table 6.3 depicts, about 46.4% of the respondents indicate their agreement, while 21.4% of the respondents strongly agree on the statement, implying that the banks have full commitment from the *Shari'ah* advisors. Their full engagement with the banks may be attributed to many factors such the advisors willingness to uphold the trust bestowed upon them or that clear roles and responsibilities are spelt out by the banks. However, 3.6% of them disagree that the *Shari'ah* advisors are resourceful and efficient while another 28.6% of the respondents remain neutral.

Table 6.3 shows that 50% of the respondents agree that the 'Shari'ah advisors are easily accessible' and 25% of the respondents strongly agree on that. This implies that the banks have committed and dedicated Shari'ah advisors to ensure continuous support to the banks. However, 7.1% of the respondents disagree that the Shari'ah advisors can be easily reached while another 17.9% of the respondents remain neutral.

Based on Table 6.3, 44.4% and 40.7% of the respondents agree and strongly agree respectively that '*Shari'ah* advisors have appropriate skill sets and experience'. This may be inferred through the way they professionally address and resolve *Shari'ah* issues. Another 14.8% of the respondents remain neutral, while none of the respondents indicate their disagreement on Shari'ah advisors having appropriate skill sets.

As reflected in Table 6.3, 60.7% of the respondents agree on the point that 'the role of *Shari'ah* advisors is to ensure that policies, procedures, fatwa adopted by the banks are in accordance with *Shari'ah* principle', while another 35.7% of them strongly with this point. This indicates that the banks have adequate policies, procedures, and *fatwas* in place before the *Shari'ah* compliance matter is put the under the purview of the Shari'ah Advisors. None of the respondents indicate any disagreement on this statement. However, the remaining 3.6% of the respondents are indifferent.

As shown in Table 6.3, 32.1% of the respondents assert that 'the role of *Shari'ah* advisors includes to actively monitor the business to safeguard shareholders' interests' and 21.4% of the respondents strongly agree with this point. This may imply that the banks have appointed dedicated *Shari'ah* advisors to safeguard the shareholders' interests. 14.3% of them however, disagree that *Shari'ah* advisors are involved in the monitoring at all and another 3.6% strongly disagree with this. This being the case, *maqasid al-Shari'ah* may not be achieved as shareholders' rights may be neglected due to an absence or lack of monitoring by the *Shari'ah* advisors. As the results indicate, 28.6% of the respondents remain neutral.

Being part of the internal control structure, it is quite apparent that *Shari'ah* advisors have to have some knowledge on internal controls relating to the banks' operations. As such, based on Table 6.3, 39.3% of the respondents agree that the '*Shari'ah* advisors ascertain internal controls and operations of bank's conduct'. This suggests that the banks have highly skilled *Shari'ah* advisors who are well-versed with the control aspect in the banking operations, while 17.9% of the respondents strongly agree, a similar percentage of the respondents disagree on this. Another 7.1% of them strongly disagree that *Shari'ah* advisors ascertain the internal controls while the remaining 17.9% of the respondents remain neutral.

To a certain extent, knowledge of the *Shari'ah* advisors on legal and regulatory issues is crucial in the development of the Islamic finance industry to accommodate to the continuous assessment of the regulator. Based on the results depicted in Table 6.3, 57.1% of the respondents agree that the '*Shari'ah* advisors ensure adequacy of compliance with legal and regulatory requirements'. This reflects that the advisors are fully engaged with their responsibilities to ensure full regulatory compliance, while 10.7% of the respondents strongly agree with the statement, a similar percentage of the respondents disagree that the *Shari'ah* advisors are involved in this matter. In fact, 7.1% of them strongly disagree on this whereas 14.3% of the respondents indicate their neutral perceptions.

In line with the *Shari'ah* precept that products have to conform to *Shari'ah* rules, 46.4% of the respondents agree that the '*Shari'ah* advisors perform product approval' and 32.1% of the respondents strongly agree with this. This implies that the banks may have put in place adequate structures to support *Shari'ah* advisors in performing their duties. About 7.1% of them disagree with this and 3.6% strongly disagree, while another 10.7% of the respondents remain neutral.

As shown in Table 6.3, 53.6% of the respondents agree that the 'bank has competent senior management to oversee business implementation', while 32.1% of the respondent strongly agree on that. This suggests that the banks have provided a clear mandate to the senior management to undertake their roles and responsibilities. However, about 7.1% of them disagree with this and the same percentage of respondents remains neutral. It should be noted that none of the respondents indicate strong disagreement on the statement.

Table 6.3 indicates that 53.6% of the respondents agree that their 'senior management develops strategic plans for board review', while another 32.1% of them strongly agree with this statement. This is reflected through the smooth undertaking of projects going on in the banks, and this may be due to the boards' involvement in reviewing the feasibility of its projects. However, 10.7% of the respondents do not agree that the senior management develops strategic plans for board review and the remaining 3.6% of the respondents are neutral.

As regards to the perceptions on the construct that 'the senior management oversees enforcement on policy implementation', the findings in Table 6.3 indicate that 53.6% of the respondents agree, while 35.7% of them strongly agree on this point. This may imply that the banks have a good system to support the senior management in their monitoring tasks, especially in the development stage. About 3.6% of them disagree with this and another 7.1% of the respondents remain neutral. None of the respondents indicate strong disagreement on this statement.

As the results in Table 6.3 show, 39.3% of the respondents assert that 'the senior management articulates the bank's missions and vision effectively to all staff' and 25% of the respondents strongly agree. This indicates that the banks have an adequate infrastructure to support effective communication. However, 7.1% of respondents disagree with this, perhaps due to a lack of transparency in communication while another 28.6% of the respondents remain neutral.

6.3.3. Perceptions on Regulatory Disclosure and Transparency

Table 6.4 presents the results with regards to the perceptions on the dimension of 'regulatory disclosure and transparency' based on the seven constructs.

As can be seen from the results in Table 6.4, 60.7% of the respondents agree that 'the bank conforms to the highest international standard and practices for financial and non-financial reporting and disclosure', and 21.4% of the respondents strongly agree with this. This may imply that the banks have a very good reputation with their credential reporting to the public and media as reported by the participants. The remaining 17.9% of them remain neutral, while none of the respondents indicate any disagreement on this statement.

The banks assert that their 'accounting standards are harmonised with the prudential standards'. This is evidenced through the survey findings reported in Table 6.4, as 64.3% of the respondents agree with the statement and another 21.4% strongly agree. To a certain extent, this may imply that the banks are complying with the regulatory requirements as well. As the results in Table 6.4 shows, none of the respondents indicate any disagreement on this statement. However, the remaining 14.3% of the respondents remain neutral.

Table 6.4: Perceptions on Regulatory Disclosure and Transparency

Construct		Frequency	Valid (%)	Mean	Mean Ranking
The bank conforms to the highest international standard & practices for financial and non-financial reporting and disclosure.	Neutral	5	17.9	4.04	3
	Agree	17	60.7		
	Strongly Agree	6	21.4		
	Total	28	100.0		
Bank accounting standards are harmonised with prudential standards.	Neutral	4	14.3	4.07	2
	Agree	18	64.3		
	Strongly Agree	6	21.4		
	Total	28	100.0		
The accounting processes produce reliable information (e.g. for investors and strategic decision making).	Neutral	2	7.1	4.21	1
	Agree	18	64.3		
	Strongly Agree	8	28.6		
	Total	28	100.0		
The bank discloses methods to calculate profits	Disagree	5	17.9	3.71	5
	Neutral	3	10.7		
	Agree	15	53.6		
	Strongly Agree	5	17.9		
	Total	28	100.0		
The bank discloses the weaknesses of the products.	Disagree	14	50.0	2.79	7
	Neutral	7	25.0		
	Agree	6	21.		
	Strongly Agree	1	3.6		
	Total	28	100.0		
The bank has no unresolved *Shari'ah* issues on its lack of standard.	Disagree	6	21.4	3.50	6
	Neutral	5	17.9		
	Agree	14	50.0		
	Strongly Agree	3	10.7		
	Total	28	100.0		
Information disclosure and transparency is appropriately done (timely and adequate).	Neutral	8	28.6	3.93	4
	Agree	14	50.0		
	Strongly Agree	6	21.4		
	Total	28	100.0		

As regards to the construct that 'the accounting processes produce reliable information (*e.g.* for investors and strategic decision making)', the results in Table 6.4 depict that 64.3% of the respondents agree and 28.6% strongly agreeing with this. This suggests that according to the perceptions of the participants, the sampled IBs

have good infrastructure in place to support the process. While none of the respondents indicate any disagreement on this statement, the remaining 7.1% of them remain neutral.

As profit sharing is one of the essential elements in IB, the disclosure of the calculation method adopted by the IBs, for instance in terms of profit calculation, is crucial to the stakeholders. Based on the findings reported in Table 6.4, 53.6% of the respondents agree that 'the bank discloses the methods to calculate profit'. At 17.9%, the percentage of the respondents who strongly agree is the same as the ones which disagree that the bank discloses its calculation methods. This, to a certain extent, implies that banks have different views on the aspect of compliance with *Shari'ah*. The remaining 10.7% of the respondents however, remain neutral.

Although IBs are expected to disclose the weaknesses of the products they offer, 50% of the respondents assert that banks do not 'disclose the weaknesses of the products'. Meanwhile, 25% of the respondents are indifferent, and 21.4% and 3.6% of them agree and strongly agree respectively that the banks disclose their products' weaknesses. This implies that the IBs have different views on disclosure which could be subject to the individual banks' business strategies.

As can be seen from Table 6.4, 50% of the respondents agree that 'the bank has no unresolved *Shari'ah* issues on its lack of standard' with 10.7% respondents who strongly agree with this. However, 21.4% of them disagree with the statement that the banks have no unresolved *Shari'ah* issues. This may imply that, to a certain extent, it portrays the assertiveness of the IBs' *Shari'ah* advisor with regards to upholding his principles. As can be seen, the remaining 17.9% of the banks' respondent are neutral on this case.

Table 6.4 reveals that 50% of the respondents agree on the statement that 'information disclosure and transparency is appropriately done or is timely and adequate, while 21.4% of the respondents strongly assert the point. This appropriateness and adequacy of information may imply that the banks have adequate resources to provide such disclosure. The remaining 28.6% of them remain neutral and none of the respondents indicate any disagreement on this construct.

6.3.4. Perceptions on the Effectiveness and Efficiency of Audit

Table 6.5 shows the perceptions on the effectiveness and efficiency of Audit in FIs based on the 7 constructs.

Table 6.5: Perceptions on the Effectiveness and Efficiency of Audit

Construct		Frequency	Valid Percent	Mean	Mean Ranking
Audit and/or review are done by independent auditors.	Neutral	2	7.1	4.36	2
	Agree	14	50.0		
	Strongly Agree	12	42.9		
	Total	28	100.0		
The bank appoints a qualified external auditor.	Neutral	1	3.6	4.43	1
	Agree	14	50.0		
	Strongly Agree	13	46.4		
	Total	28	100.0		
The board reviews the scope of audit.	Disagree	1	3.6	4.04	6
	Neutral	3	10.7		
	Agree	18	64.3		
	Strongly Agree	6	21.4		
	Total	28	100.0		
The board are aware of the highlighted audit findings.	Disagree	1	3.6	4.21	5
	Neutral	1	3.6		
	Agree	17	60.7		
	Strongly Agree	9	32.1		
	Total	28	100.0		
The board ensures external auditors have adequate expertise to conduct *Shari'ah* audit.	Strongly Disagree	1	3.6	3.39	7
	Disagree	5	17.9		
	Neutral	7	25.0		
	Agree	12	42.9		
	Strongly Agree	3	10.7		
	Total	28	100.0		
Auditors ensure the truth and fairness of the financial statements.	Neutral	1	3.6	4.29	4
	Agree	18	64.3		
	Strongly Agree	9	32.1		
	Total	28	100.0		
Regular audit and compliance assessments continuously take place.	Neutral	2	7.1	4.32	3
	Agree	15	53.6		
	Strongly Agree	11	39.3		
	Total	28	100.0		

As shown in Table 6.5, 50% of the respondents agree that 'audit and review are done by independent auditors', while 42.9% of the respondents strongly agree with this. This implies that the banks are receptive in accepting comments. It also suggests that according to the perceptions of the participants, the banks agree with the appointment of high credential auditors and ensure that check and balance tasks are professionally performed. As the results show, no responses indicate otherwise, except that the remaining 7.1% of them remain neutral.

It is possible that IBs consider the independence of external auditors as crucial in maintaining and enhancing the credibility of the bank. Based on Table 6.5, 50% of the respondents agree that their 'banks appoint qualified external auditors' and 46.4% strongly agree with that. This suggests that the banks are prudent with regards to the auditors' appointment as only auditors of certain qualities are chosen to perform audit. The remaining 3.6% of them, however, remain neutral.

Since 64.3% of the respondents assert that the 'board reviews the scope of audit' and 21.4% strongly agree with that, it could imply that the board is hands on with audit issues. It also suggests that the board always ensures that critical areas are examined and any issues are addressed comprehensively. However, 10.7% of them remain neutral, 3.6% of the respondents disagreeing with this could probably be due to inadequate hands-on experience with respect to audit.

It is shown in Table 6.5 that 60.7% of the respondents agree that 'the board are aware of the highlighted audit findings' with 32.1% strongly asserting this. Hence, this could imply that according to the perceptions of the participants, the board is fully aware of the repercussions triggered by the issues and are thus are in a better position to address any forthcoming problems highlighted by the auditors. However, the respondents who do not agree with this construct and those who are indifferent account for 3.6% each.

Based on Table 6.5, 42.9% of the respondents agree that 'the board ensures external auditors have adequate expertise to conduct *Shari'ah* audit' and another 10.7% strongly agree with construct. However, 17.9% disagree and 3.6% strongly disagree that the board ensures the adequacy of external auditors' expertise. In addition, the remaining 25% of them remain neutral. This suggests the need for further

development in *Shari'ah* audit areas as auditors on *Shari'ah* knowledge are still not well-developed.

As the results in Table 6.5 show, 64.3% of the respondents agree that 'auditors ensure the truth and fairness of the financial statements' with 32.1% strongly agreeing with this construct. This implies that according to the perceptions of the participants, IBs have very strong faith in the auditors' integrity. To a certain extent, this implies that, for the participants, most auditors have very strong dignity and ethicality in performing their jobs, especially as far as IBs are concerned. The results show that the remaining 3.6% of them remain neutral, while none of the respondents indicate any disagreement on this statement.

Based on the survey findings presented in Table 6.5, 53.6% of the respondents agree that 'regular audit and compliance assessments continuously take place' with 39.3% strongly agreeing with this. This suggests that banks seriously emphasise audit with regards to compliance although audit is perceived as utilising too much of the bank's resources. Thus, none of the respondents disagree that the banks are not doing regular audit. The remaining 7.1% of the respondents, however, remain neutral.

6.3.5. Perceptions on Appropriateness and Comprehensiveness of Policies and Procedures

Table 6.6 shows the result of perceptions on the dimension 'appropriateness and comprehensiveness of the banks' policies and procedures' based on 7 constructs.

As the Table 6.6 show, 50% of the respondents agree that '*Shari'ah* governance framework is comprehensive' and 21.4% of them strongly agree with this. This implies that the banks have policies and procedures in place to ensure the continuity of the operations while maintaining a uniform and standardised way of carrying out tasks. In addition, the respondents who disagree and those who are indifferent account for 14.3% each, while none of the respondents indicate any strong disagreement on this statement.

Table 6.6: Perceptions on Appropriateness and Comprehensiveness of Policies and Procedures

Construct		Frequency	Valid (%)	Mean	Mean Ranking	Standard Deviation
Shari'ah governance framework is comprehensive.	Disagree	4	14.3	3.79	11	0.96
	Neutral	4	14.3			
	Agree	14	50.0			
	Strongly Agree	6	21.4			
	Total	28	100.0			
Shari'ah-related strategies and principles are approved by *Shari'ah* advisors	Disagree	1	3.6	4.18	1	0.72
	Neutral	2	7.1			
	Agree	16	57.1			
	Strongly Agree	9	32.1			
	Total	28	100.0			
Shari'ah-related strategies and principles are incorporated in the business strategy	Disagree	2	7.1	3.96	6	0.79
	Neutral	3	10.7			
	Agree	17	60.7			
	Strongly Agree	6	21.4			
	Total	28	100.0			
The business strategies define the eligible counterparties	Disagree	1	3.6	4.00	4	0.61
	Neutral	2	7.1			
	Agree	21	75.0			
	Strongly Agree	4	14.3			
	Total	28	100.0			
The business strategies define the nature of approved *Shari'ah* compliant financing	Disagree	1	3.6	3.93	7	0.60
	Neutral	3	10.7			
	Agree	21	75.0			
	Strongly Agree	3	10.7			
	Total	28	100.0			
The bank has comprehensive policies and procedures to support compliance with board policy.	Neutral	4	14.3	4.07	3	0.60
	Agree	18	64.3			
	Strongly Agree	6	21.4			
	Total	28	100.0			
The policies and procedures address *Shari'ah* matter	Neutral	3	10.7	4.11	2	0.57
	Agree	19	67.9			
	Strongly Agree	6	21.4			
	Total	28	100.0			
The policies and procedures address legal matter	Disagree	1	3.6	3.93	7	0.60
	Neutral	3	10.7			
	Agree	21	75.0			
	Strongly Agree	3	10.7			
	Total	28	100.0			
The policies and procedures ensure guidance on details of the bank's business	Disagree	1	3.6	4.00	4	0.67
	Neutral	3	10.7			
	Agree	19	67.9			
	Strongly Agree	5	17.9			
	Total	28	100.0			
The policies and procedures are effective	Disagree	2	7.1	3.86	10	0.76
	Neutral	4	14.3			
	Agree	18	64.3			
	Strongly Agree	4	14.3			
	Total	28	100.0			

Construct		Frequency	Valid (%)	Mean	Mean Ranking	Standard Deviation
The policies and procedures are regularly revised.	Disagree Neutral Agree Strongly Agree Total	1 8 15 4 28	3.6 28.6 53.6 14.3 100.0	3.79	11	0.74
The policies and procedures are communicated across the board.	Neutral Agree Strongly Agree Total	8 14 6 28	28.6 50.0 21.4 100.0	3.93	7	0.72

As regards to the construct '*Shari'ah*-related strategies and principles are approved by *Shari'ah* advisors', the results in Table 6.6 show that 57.1% of the respondents expressed agreement, while 32.1% strongly agree with the statement. This suggests that, according to the perceptions of the participants, the IBs' strategies and principles are in conformance with *Shari'ah* principles. However, 3.6% disagree and the remaining 7.1% of them remain neutral. While *Shari'ah* related strategies and principles should be approved by *Shari'ah* advisors, it is important that the former is clearly spelt out to ease interpretation.

Since IBs are expected to uphold Islamic principles in their business conduct, its strategy should be in conformance with the *Shari'ah*. In relation to this, about 60.7% of the respondents agree that '*Shari'ah*-related strategies and principles are incorporated into the business strategy' and 21.4% strongly agree with this. This implies that according to the participants, *Shari'ah* advisors' inputs are taken into account in outlining the business strategies. However, 7.1% disagree, while 10.7% of them remain neutral in relation to this construct. As the Table 6.6 shows, none of the respondents indicate any strong disagreement on this statement.

One of the ways of doing Islamic business is to ascertain that each business conduct is performed in a permissible manner. For example, the counterparties for the business have to undertake business in accordance with Islamic principles. In relation to this, Table 6.6 shows that 75% of the respondents agree that 'the business strategies define the eligible counterparties' with 14.3% strongly agreeing with this. However, 3.6% disagree while 7.1% of them remain neutral.

As can be seen from the findings demonstrated in Table 6.6, 75% of the respondents agree that 'the bank's business strategies define the nature of approved *Shari'ah*

compliant financing' and 10.7% of the respondents strongly agree with this statement. This implies that the banks are being, to a certain extent, transparent with regards to describing their nature of financing. However, 3.6% disagree while 10.7% of them remain neutral.

As regards to the construct the bank has comprehensive policies and procedures to support compliance with board policy', about 64.3% of the respondents expressed agreement with 21.4% strongly agreeing with this. As can be seen, the remaining 14.3% of them are neutral, while none of the respondents indicate any strong disagreement on this statement. This implies that, according to the participants, most banks agree that policies and procedures should not conflict with compliance in any circumstances, otherwise this could be the loophole that leads towards discrepancies and other such things.

As depicted in Table 6.6, about 67.9% of the respondents agree that 'the policies and procedures address *Shari'ah* matter', while 21.4% of the respondents strongly agree with this. However for banks which operate a dual system, it may suggest that they have separate documentation for conventional and Islamic banking. The remaining 10.7% of the respondents, however, are indifferent in this matter.

As regards to the construct that 'the policies and procedures address legal matter', as the results in Table 6.6 show, 75% of the respondents expressed agreement, while 10.7% of the respondents strongly agree with this. This implies that banks' banking practices are in line with the laws and regulations as the policies and procedures adopted by the bank are in conformance with the regulatory aspect. However, 3.6% of the respondents disagree and 10.7% of them remain neutral, and none of the respondents indicate any strong disagreement on this statement.

Since 67.9% of the respondents agree that 'the policies and procedures ensure guidance on details of the bank's business' and another 17.9% of them strongly agree with the statement, this suggests that the respondents have the opinion that IBs' policies and procedures are comprehensive and appropriate to guide banking operations. About 3.6% of the respondents, however, disagree, while 10.7% of them remain neutral. This could be because some banks may not have adequate policies and

procedures in place as sometimes not everything can be spelt out, depending on circumstances.

It is generally accepted that policies and procedures are important, as they need to be cohesive and practical to be used in day-to-day banking operations. As such, 64.3% of the respondents agree that the 'policies and procedures are effective' in IBs with 14.3% strongly agreeing with this. This indicates that, according to the participants, the banks have appropriate structures in place and the adequate manpower to take care of the documentation aspect. However, 7.1% disagree while 14.3% of them remain neutral.

The survey results in Table 6.6 indicate that 53.6% of the respondents agree that 'the policies and procedures are regularly revised' and another 14.3% of them strongly agree with this. This suggests that banks are aware that policies and procedures are vital in addressing the banking business's evolving needs. However, 3.6% disagree while 28.6% of them remain neutral.

As shown in Table 6.6, 50% of the respondents agree that 'the policies and procedures are communicated across the board' and another 21.4% of them strongly agree with this. This implies that according to the participants, the sampled banks have effective communication channels. The remaining 28.6% of the respondents are neutral, and this could be due to the absence of appropriate policies and procedures or a lack of infrastructure to support effective communication. None of the respondents indicate any strong disagreement on this statement.

6.3.6. Perceptions on the Efficiency of Support and Operations

Table 6.7 depicts the general perceptions of the bank with respect to the 'efficiency of the banks in terms of support and operations' based on 12 constructs.

As indicated by Table 6.7, 57.1% of the respondents agree that 'the bank's control processes are adequate' to support the bank's operations with 10.7% strongly agreeing with this. This suggests that the banks have adequate and relevant resources in place to implement controls in the banks' operations. However, 10.7% of the respondents disagreeing with this presumably could be due to a lack of security awareness or

inadequate infrastructure to put controls in place. The remaining 21.4% of the respondents are neutral.

Table 6.7: Perceptions on the Efficiency of Support and Operations

Construct		Frequency	Valid (%)	Mean	Mean Ranking	Standard Deviation
Control processes are adequate	Disagree	3	10.7	3.68	1	0.82
	Neutral	6	21.4			
	Agree	16	57.1			
	Strongly Agree	3	10.7			
	Total	28	100.0			
Control processes are effective.	Disagree	4	14.3	3.54	2	0.88
	Neutral	8	28.6			
	Agree	13	46.4			
	Strongly Agree	3	10.7			
	Total	28	100.0			
The bank has adequate resources to support the bank's operations.	Strongly Disagree	1	3.6	3.54	2	0.96
	Disagree	3	10.7			
	Neutral	7	25.0			
	Agree	14	50.0			
	Strongly Agree	3	10.7			
	Total	28	100.0			
The bank has an efficient system to support key business operation.	Strongly Disagree	1	3.6	3.36	8	0.95
	Disagree	5	17.9			
	Neutral	6	21.4			
	Agree	15	53.6			
	Strongly Agree	1	3.6			
	Total	28	100.0			
The bank has appropriate systems to help with complying to *Shari'ah* in terms of products and services.	Disagree	6	21.4	3.50	5	0.96
	Neutral	5	17.9			
	Agree	14	50.0			
	Strongly Agree	3	10.7			
	Total	28	100.0			
The bank has a good reporting, documentation, and records management system.	Disagree	4	14.3	3.54	2	0.84
	Neutral	7	25.0			
	Agree	15	53.6			
	Strongly Agree	2	7.1			
	Total	28	100.0			

Construct		Frequency	Valid (%)	Mean	Mean Ranking	Standard Deviation
The bank has effective information & comm. technology to ensure the dissemination of info. to the mgt.	Disagree	4	14.3	3.50	5	0.79
	Neutral	7	25.0			
	Agree	16	57.1			
	Strongly Agree	1	3.6			
	Total	28	100.0			
The bank has put in place adequate and appropriate trainings for senior management and all employees.	Strongly Disagree	1	3.6	3.46	7	1.04
	Disagree	5	17.9			
	Neutral	5	17.9			
	Agree	14	50.0			
	Strongly Agree	3	10.7			
	Total	28	100.0			

The findings in Table 6.7 show that 46.4% of the respondents agree with the construct that 'the control processes are effective', while 10.7% of them strongly agree with this. Presumably, this reflects, according to the respondents, that the banks have robust systems that can accommodate to business needs. Another 14.3%, however, disagree with this while the remaining 28.6% of the respondents are neutral.

As can be seen from the results, 50% of the respondents agree that 'the bank has adequate resources to support the banks' operations' and 10.7% of them strongly agree with the statement. This may imply participants are in the opinion that the banks have a low staff turnover and thus can retain highly qualified personnel. However, 10.7% of the respondents disagree with this and another 3.6% indicate very strong disagreement apart from the remaining 25% of the respondents who remain neutral.

Table 6.7 shows that 53.6% of the respondents agree that 'the bank has an efficient system to support key business operations' with 3.6% strongly agreeing with this. Perhaps the banks have an IT-literate board and top management who are inclined towards the latest in technology to cater for a highly demanding market segment. About 17.9% of the respondents disagree with this with 3.6% strongly disagreeing with this. The remaining 21.4% are neutral.

Based on the survey results in Table 6.7, 50% of the respondents agree that 'the bank has appropriate systems to help with complying with *Shari'ah* in terms of products and services' and another 10.7% of them strongly agree with this. About 21.4% of the

respondents disagree with this. The remaining 17.9% are neutral. None of the respondents indicate any strong disagreement on this statement.

53.6% of the respondents agree that 'the bank has a good reporting, documentation, and records management system' and 7.1% of them strongly agree with the statement This implies that according to the participants, these banks emphasise good reporting and highly regard documentation and good record management systems. The 14.3% of the respondents disagreeing with this could be due to a lack of resources to support adequate documentation. The remaining 25% are neutral.

Table 6.7 reveals that 57.1% of the respondents agree that 'the bank has effective information and communication technology to ensure the dissemination is effective' and another 3.6% of the respondents strongly agree with this. This implies that most banks are equipped with adequate infrastructure with regards to ICT to support the business. About 14.3% of the respondents disagree with this though and this may be one of the best practices to instil awareness among the staff. Perhaps this is due to the banks not having the adequate infrastructure to support it. The remaining 25% are neutral with respect to information to the management. None of the respondents indicate any strong disagreement on this statement.

As the results in Table 6.7 depict, 50% of the respondents agree that 'the bank has put in place adequate and appropriate training for senior management and all employees' while 10.7% of the respondents strongly agree with this. This should be considered as IBs place emphasis on staff development. Despite training possibly being highly regarded by banks, it still may be perceived as irrelevant by 17.9% of the respondents who disagree and another 3.6% of them who strongly disagree on the statement. Perhaps this is due to budget constraints and resource utilisation. The remaining 17.9% are neutral.

6.4. PERCEPTIONS ON RISK MANAGEMENT

The preceding section presented the findings developed from the perceptions and opinions of the participants on CG related issues. This section focuses on risk management practices as related by the participants. It should be noted that the perceptions on CG and RM in this section represents the views of the supply side namely the management of the IBs.

As above, this section presents the findings in relation to RM dimensions and clusters.

6.4.1. Perceptions on General Risk Management Practice

Table 6.8 shows the respondents' perceptions on the general risk management practices of the banks based on the 19 constructs. The details below indicate that, in general, perceptions on risk management are highly encouraging. This may imply that the banks under survey have adequate resources to support them in managing risk.

Table 6.8: Perceptions on General Risk Management Practice

Construct		Frequency	Valid Percent	Mean	Mean Ranking	Standard Deviation
There is adequate board risk oversight function.	Disagree	1	3.6	4.00	8	0.82
	Neutral	6	21.4			
	Agree	13	46.4			
	Strongly Agree	8	28.6			
	Total	28	100.0			
There is a robust risk management framework that is aligned with *Shari'ah* principles in place.	Disagree	2	7.1	3.86	16	0.80
	Neutral	5	17.9			
	Agree	16	57.1			
	Strongly Agree	5	17.9			
	Total	28	100.0			
Risk assessment is incorporated into all business decision making.	Disagree	1	3.6	3.96	10	0.58
	Neutral	2	7.1			
	Agree	22	78.6			
	Strongly Agree	3	10.7			
	Total	28	100.0			
The board understands risk management as the key drivers of success in corporate strategies.	Disagree	1	3.6	4.00	8	0.72
	Neutral	4	14.3			
	Agree	17	60.7			
	Strongly Agree	6	21.4			
	Total	28	100.0			
The board ascertains CEO and senior management are fully engaged with risk management.	Neutral	7	25.0	3.96	10	0.69
	Agree	15	53.6			
	Strongly Agree	6	21.4			
	Total	28	100.0			

Construct		Frequency	Valid Percent	Mean	Mean Ranking	Standard Deviation
The board ensures independent risk management and business functions.	Disagree	1	3.6	4.07	4	0.72
	Neutral	3	10.7			
	Agree	17	60.7			
	Strongly Agree	7	25.0			
	Total	28	100.0			
The board ensures policies and procedures in relation to risk adopted by the management are appropriate and comprehensive.	Disagree	1	3.6	3.96	10	0.64
	Neutral	3	10.7			
	Agree	20	71.4			
	Strongly Agree	4	14.3			
	Total	28	100.0			
The board oversees the management's implementation of policies and procedures of risk are followed and effective.	Neutral	5	17.9	4.07	4	0.66
	Agree	16	57.1			
	Strongly Agree	7	25.0			
	Total	28	100.0			
The board knows whether the management has appropriately responded to risks.	Disagree	1	3.6	4.04	7	0.64
	Neutral	2	7.1			
	Agree	20	71.4			
	Strongly Agree	5	17.9			
	Total	28	100.0			
The board monitors the potential risk in the bank's culture and incentive system.	Disagree	4	14.3	3.79	17	0.88
	Neutral	2	7.1			
	Agree	18	64.3			
	Strongly Agree	4	14.3			
	Total	28	100.0			
The board reviews with the management risk appetite and other risk-related matters.	Disagree	1	3.6	3.89	15	0.69
	Neutral	5	17.9			
	Agree	18	64.3			
	Strongly Agree	4	14.3			
	Total	28	100.0			
The board reviews with the management risk management policies and procedures.	Neutral	4	14.3	4.11	2	0.63
	Agree	17	60.7			
	Strongly Agree	7	25.0			
	Total	28	100.0			
The board reviews with the management reports on risk-matter from the audit, legal departments and regulators.	Neutral	4	14.3	4.11	2	0.63
	Agree	17	60.7			
	Strongly Agree	7	25.0			
	Total	28	100.0			

Construct		Frequency	Valid Percent	Mean	Mean Ranking	Standard Deviation
Shari'ah advisors are aware of the risk exposure that arises from different jurisdictions in different locations.	Strongly Disagree	1	3.6	3.46	18	1.00
	Disagree	3	10.7			
	Neutral	10	35.7			
	Agree	10	35.7			
	Strongly Agree	4	14.3			
	Total	28	100.0			
The bank has a dedicated unit to undertake the risk management process to manage each type of risk.	Strongly Disagree	1	3.6	4.07	4	0.94
	Disagree	1	3.6			
	Neutral	2	7.1			
	Agree	15	53.6			
	Strongly Agree	9	32.1			
	Total	28	100.0			
The bank has competent and well-trained personnel to undertake risk management functions	Strongly Disagree	1	3.6	3.96	10	0.88
	Neutral	5	17.9			
	Agree	15	53.6			
	Strongly Agree	7	25.0			
	Total	28	100.0			
The bank has strong MIS to support the risk management system.	Strongly Disagree	3	10.7	3.39	19	1.26
	Disagree	4	14.3			
	Neutral	5	17.9			
	Agree	11	39.3			
	Strongly Agree	5	17.9			
	Total	28	100.0			
The controls take into account the integrity of the risk management process.	Disagree	3	10.7	3.96	10	0.84
	Neutral	1	3.6			
	Agree	18	64.3			
	Strongly Agree	6	21.4			
	Total	28	100.0			
The controls comply with the regulatory and internal policies and procedures.	Disagree	1	3.6	4.18	1	0.61
	Agree	20	71.4			
	Strongly Agree	7	25.0			
	Total	28	100.0			

As can be seen in Table 6.8, according to the participants, the board is aware of the banks' strategies and is well-versed in the banks' risk management aspects, as 46.4% of the respondents agree that there is 'adequate board risk oversight function' and another 28.6% of the respondents assert this strongly. Hence, these findings indicate that boards are aware of the bank's risk appetite and to a certain degree are involved in the risk management process in an appropriate and transparent manner with the

presence of independent risk management through the CEO to manage the succession process. As can be seen, 21.4% of the respondents remain neutral, while the remaining 3.6% of them disagree that the board provides oversight.

The survey results in Table 6.8 indicate that 57.1% of the respondents agree that a 'robust risk management framework aligned with *Shari'ah* principles' is in place, while 17.9% of the respondents strongly agree with this. This could be attributed to the regulatory requirements imposed by the government to ascertain adequate *Shari'ah* governance through its risk management function. 7.1% of the respondents disagree and another 17.9% of the respondents remain neutral.

It is well known that risk assessment provides a basis for selecting alternatives and acts as a measure as to why alternatives are chosen. As such, 78.6% respondents agree that 'risk assessment is incorporated into all business decision-making', while another 10.7% of them strongly agree with this. As can be seen in Table 6.8, none of the respondents indicate strong disagreement on this statement except for a small percentage making up 3.6% of the respondents. This could be due to the complexity of the task or some other constraints such as system limitations, and etc. Another 7.1% of the respondents remain neutral.

As an important aspect of RM, boards need to understand risk to help them make better decisions on the need for action, to identify critical success factors, and to gauge aspects of resource allocation among other things. In relation to this, the results in Table 6.8 show that about 60.7% of the respondents agree that their 'board understands risk management as the key drivers of success in corporate strategies' and 21.4% of them strongly agree with this. However, those who disagree make up 3.6% of the respondents, while another 14.3% of the respondents remain neutral. None of the respondents indicate strong disagreement on this statement.

The succession of the banks depends on the ability of the CEO to steer the banks with full commitment from the senior management team. Based on the survey results in Table 6.8, 53.6% of the respondents agree that their 'board ascertains that CEO and senior management are fully engaged with risk management', while another 21.4% strongly assert this point. This could be reflected through regular board risk meetings in which the CEO and top management continuously feed the board with relevant and

appropriate input. It should be noted that the remaining 25% of the respondents remain neutral. This implies that the participants are in the view that despite some commitment from the CEO and top management, their output is still trivial as they are comparatively highly compensated by the banks. Nonetheless, none of the respondents indicate any disagreement on this statement.

In practice, the business and risk management sides are always segregated. This is in line with the response as 60.7% of the respondents agree that 'the board ensures independent risk management and business functions' and another 25% of them strongly agree with this. This implies that according to the participants, adequate controls are in place as there is a certain level of security awareness among the board members and top management. However, those who disagree make up 3.6% of the respondents while the remaining 10.7% of the respondents remain neutral. None of the respondents indicate strong disagreement on this statement.

As an important aspect of RM, policies and procedures are normally developed by the relevant department but reviewed and endorsed by the board. As can be seen in Table 6.8, about 71.4% of the respondents agree that 'the board ensures policies and procedures in relation to risk adopted by the management are appropriate and comprehensive', and another 14.3% of them strongly agree with this. However, those who disagree make up 3.6% of the respondents, while the remaining 10.7% of the respondents remain neutral. It should be noted that none of the respondents indicate strong disagreement on this statement. This implies that according to the participants, the board is aware of the banks policies and procedures and ensures that they are appropriate and up-to-date.

Table 6.8 shows that 57.1% of the respondents agree that 'the board oversees the management's implementation of policies and procedures of risk are followed and effective' with 25% of them strongly agreeing with this. The remaining 17.9% of the respondents remain neutral. None of the respondents indicate strong disagreement on this statement. Thus, according to the participants, the banks' policies and procedures are up-to-date and adequate to ensure that implementation can be strictly and effectively followed.

The survey results in Table 6.8 reveal that 71.4% of the respondents agree that 'the board knows whether the management has appropriately responded to risks' with 17.9% of them strongly agreeing with this. This implies that, according to the participants, the management has been given an adequate mandate to respond to risk matters. This may be reflected through their timely responses in addressing risk issues. However those who disagree make up 3.6% of the respondents. The remaining 7.1% of the respondents remain neutral.

As regards to the RM construct that 'the board monitors the potential risk in the bank's culture and incentive system', the findings in Table 6.8 evidence that 64.3% and 14.3% of the respondents agree and strongly agree respectively. Thus, according to the participants, the banks have appropriate structures and committees in place to support the board on risk matters. This further suggests that the board is able to monitor potential risk in the bank's culture and incentive system based on the information brought to them. It should be noted that 14.3% disagree with the statement, while 7.1% of them are neutral on this.

With adequate information brought to the board, the board can 'review risk-related matter with the management'. In relation to this, the findings in Table 6.8 indicate that 64.3% of the respondents agree that the board works with the management on risk appetite, risk exposure, and other such issues and 14.3% of the respondents strongly agree with this. This implies that the boards are not side-lined by the management but are well-informed on risk matters. While 17.9% of the respondents are being neutral, the remaining 3.6% of them disagree on the statement that board reviews risks matters.

The results in Table 6.8 show that 60.7% of the respondents agree that the 'board reviews the risk management policies and procedures with the risk management' and another 25% of them strongly agree on this. This suggests that the banks have sound and coherent risk management policies and procedures, as the documents are assessed by the board. The remaining 14.3% of the respondents are neutral on this policies and procedures matter.

Based on the survey results in Table 6.8, 60.7% and 25% of the respondents agree and strongly agree that the 'board reviews reports on risk-matter from the audit, legal

departments and regulators with the management'. Thus, as identified by the participants, the board being involved in reviewing those reports reflects that they are fully engaged with day-to-day operations. The remaining 14.3% of the respondents show that they are neutral on this matter.

The survey results reveal that 35.7% of the respondents agree that '*Shari'ah* advisors are aware of the risk exposure that arises from different jurisdictions in different locations'. In addition, 14.3% of them strongly agree with the statement. To a certain extent, according to the participants this indicates that the banks' level of *Shari'ah* compliance may vary according to their risk appetite. This may also be influenced by the *Shari'ah* advisors of the banks. While 10.7% and 3.6% disagree and strongly disagree, the remaining 35.7% of the respondents are neutral.

As regards to the RM construct of 'bank has a dedicated unit to undertake the risk management process to manage each type of risk', the survey reveals that 53.6% agree and another 32.1% of them strongly agree with the statement. This implies that the banks have good organisational structures and appropriate reporting lines. However, 3.6% of them strongly disagree and disagree with the statements respectively, presumably due to inadequate resources or skill sets for such a dedicated unit for each type of risk. The remaining 7.1% of the respondents are neutral.

It is evidenced from the findings depicted in Table 6.8 that 53.6% of the respondents agree that 'the bank has competent and well-trained personnel to undertake risk management functions' and another 25.0% of them strongly agree with this. This suggests that, according to the participants, the banks have good remuneration and nomination committees to take care of staff welfare. However, 3.6% of the respondents strongly disagree on the statement and another 17.9% of the respondents are indifferent.

Based on the findings presented in Table 6.8, 39.3% of the respondents agree that 'the bank has strong MIS to support the risk management system'. This, according to the participants, suggests that the banks have adequate personnel with high technical knowledge to ensure the reliability and continuity of the IT system to support the business. About 17.9% of the respondents strongly agree. However, 14.3% of them

disagree and 10.7% of the respondents indicate strong disagreement on the statement, while another 17.9% of the respondents remain neutral.

It is shown in Table 6.8 that 64.3% of the respondents agree that 'the controls take into account the integrity of the risk management process' and another 21.4% of the respondents strongly agree with the statement. Thus according to the respondents the sampled IBs have robust security awareness. It should, however, be noted that 10.7% of the respondents disagree and the remaining 3.6% of them are neutral with regards to the integrity of the process.

The finding depicted in Table 6.8 show that 71.4% of the respondents agree that 'the bank comply with the regulatory and internal policies and procedures', while another 25% of the respondents strongly agree. This, according to the respondents' view, suggests that the banks have sound governance in the banking systems. However, 3.6% of the respondents disagree with the statement while no respondents remain neutral.

6.4.2. Perceptions on Credit Risk

This section focuses on the results developed from the RM dimension of 'perceptions on credit risk' with 11 constructs referring to various aspects of credit and market risk management. The results are Table 6.9 show the perceptions of the respondent on the market and credit risk of the banks.

Table 6.9: Perceptions on Credit Risk

Construct		Frequency	Valid (%)	Mean	Mean Ranking	Standard Deviation
The financing strategies for various instruments comply with *Shari'ah*.	Disagree	3	10.7	4.04	4	0.96
	Neutral	3	10.7			
	Agree	12	42.9			
	Strongly Agree	10	35.7			
	Total	28	100.0			
The bank financing strategies include formal exclusions of any engagement that deals with haram or unlawful goods and services.	Agree	16	57.1	4.43	1	0.50
	Strongly Agree	12	42.9			
	Total	28	100.0			
The credit guidelines address credit risk associated with the specific features of Islamic financing contracts.	Disagree	1	3.6	4.04	4	0.58
	Neutral	1	3.6			
	Agree	22	78.6			
	Strongly Agree	4	14.3			
	Total	28	100.0			
The list of all allowable types of transaction are kept up-to-date and communicated to the relevant staff.	Disagree	3	10.7	3.86	10	0.85
	Neutral	3	10.7			
	Agree	17	60.7			
	Strongly Agree	5	17.9			
	Total	28	100.0			
The credit policies and procedures guide towards proper credit assessments.0.51	Neutral	1	3.6	4.18	2	0.48
	Agree	21	75.0			
	Strongly Agree	6	21.4			
	Total	28	100.0			
The credit policies and procedures address loan charge-offs and recoveries.	Neutral	4	14.3	3.96	7	0.51
	Agree	21	75.0			
	Strongly Agree	3	10.7			
	Total	28	100.0			
The credit policies and procedures consider current collateral values where applicable in the recovery process.	Neutral	2	7.1	4.04	4	0.43
	Agree	23	82.1			
	Strongly Agree	3	10.7			
	Total	28	100.0			
The bank is able to recognize potential credit exposure at different stages of financing.	Strongly Disagree	1	3.6	3.96	7	0.74
	Neutral	2	7.1			
	Agree	21	75.0			
	Strongly Agree	4	14.3			
	Total	28	100.0			

Construct		Frequency	Valid (%)	Mean	Mean Ranking	Standard Deviation
The bank is aware of the relevant internal and external factors that may affect loan collectability.	Strongly Disagree	1	3.6	4.07	3	0.77
	Neutral	1	3.6			
	Agree	20	71.4			
	Strongly Agree	6	21.4			
	Total	28	100.0			
The bank has specific methods used to validate models for credit risk assessment and credit risk management tools (e.g. stress tests and back tests).	Strongly Disagree	1	3.6	3.93	9	0.90
	Disagree	1	3.6			
	Neutral	3	10.7			
	Agree	17	60.7			
	Strongly Agree	6	21.4			
	Total	28	100.0			
The bank has appropriate tools, procedures and data used to improve the impairment of loans.	Strongly Disagree	1	3.6	3.82	11	0.82
	Disagree	1	3.6			
	Neutral	3	10.7			
	Agree	20	71.4			
	Strongly Agree	3	10.7			
	Total	28	100.0			

The findings in Table 6.9 indicate that 42.9% of the respondents agree that 'the financing strategies for various instruments comply with *Shari'ah*' and 35.7% of the respondents strongly agree with the statement. Thus, according to the participants, IBs have the proper structure and adequate resources to help support the banking business. It should be noted that 10.7% disagree, while the same percentage of the respondents remains neutral.

The survey results in Table 6.9 reveal that 57.1% of the respondents agree that 'the bank financing strategies include formal exclusions of any engagement that deals with haram or unlawful goods and services', while 42.9% of the respondents strongly agree on this point. No respondents have disagreements or are neutral on this statement. This implies that according to the participants the IBs, to a certain extent, will reveal any elements of unlawful arrangements so as to ascertain the integrity of Islamic banks.

Based on the findings depicted in Table 6.9, 78.6% of the respondents agree 'the credit guidelines address credit risk associated with the specific features of Islamic financing contracts', while another 14.3% of them strongly agree with the point. The respondents who disagree and those who are indifferent with the statement each represent 3.6% of the respondents. This may infer that the banks have in place some arrangement which could be in terms of policies or any documentation that helps both parties in trying to avoid a misunderstanding so as to abide by Islamic principles.

In examining the responses from the survey, it is found that 60.7% of the respondents agree that 'the list of all allowable types of transaction are kept up-to-date and communicated to the relevant staff'. In addition, 17.9% of the respondents strongly agree on the point. This implies according to the respondents that the IBs have good documentation systems and they ascertain effective and efficient communications across the board. As can be seen, those who disagree and are indifferent on this point account for 10.7% of the respondents respectively.

Table 6.9 indicates that 75% of the respondents agree that 'the credit policies and procedures guide towards proper credit assessments', while 21.4% of the respondents strongly agree. While another 3.6% respondents remain neutral, there is no disagreement on this statement. This implies that banks have proper documentation to ensure standardisation and continuity. With high staff turnover, and merger and acquisition exercises for instance, the banks may consistently update their credit policies and procedures where relevant to cater for the changes.

The survey results in Table 6.9 reveal that 75% of the respondents agree that 'the credit policies and procedures address loan charge-offs and recoveries' and another 10.7% of the respondents strongly agree. Thus, according to the participants, their IBs have transparent policies and procedures in place. However this does not mean that the policies are clearly communicated to the counterparties. The results show that 14.3% of the respondents remain neutral and there is no disagreement on this statement.

As regards to the RM construct that 'the bank considers current collateral values where applicable, in the recovery processes', the results in Table 6.9 show that 82.1% of the respondents expressed agreement, while 10.7% of the respondents opted for the

strongly agree position. The fact that the banks' systems can accommodate details such as current collateral value implies that the banks have the adequate technical expertise to accommodate to the complex financial requirements. As can be seen, 7.1% of the respondents remain neutral and no respondents disagree with this statement.

Table 6.9 demonstrates that 75% of the respondents agree that the bank is 'able to recognize potential credit exposure at different stages of financing', while 14.3% of the respondents strongly agree on this. Thus, according to the participants the banks have very experienced staff to manage credit risk as this requires people with very high financial technical knowledge to be able to recognise the potential exposure. However, 3.6% strongly disagree and another 7.1% respondents remain neutral.

Based on findings presented in Table 6.9, 71.4% of the respondents agree that 'the bank is aware of the relevant internal and external factors that may affect loan collectability', while 21.4% strongly agree on this point. This implies that participants are in the view that their respective IBs have good and experienced staff to manage the loan recovery process which needs to be supported by an adequate legal structure. It should be noted that even though there is no disagreement, 3.6% of the respondents posed strong disagreement with the statement. The remaining 3.6% of respondents are neutral.

According to survey results presented in Table 6.9, 60.7% of the respondents agree that 'the bank has specific methods used to validate models for credit risk assessment and credit risk management tools (*e.g.* stress tests and back tests)'. In addition, 21.4 % of the respondents strongly agree with the statement. The percentage of respondents who disagree and strongly disagree are similar, both at 3.6%, while 10.7% of the respondents are neutral. This is quite a controversial as not many are willing to explain the models apart from claiming that the bank operates in accordance with the *Shari'ah*.

As regards to the construct that 'the banks have appropriate tools, procedures and data used to improve the impairment of loans', the results in Table 6.9 show that 71.4% of the respondents agree, while 10.7% of them strongly agree with this. However, the respondents who disagree and strongly disagree that the banks have appropriate tools,

procedures and data each represent 3.6% of the respondents. The remaining 10.7% respondents are neutral. This could be due to the technical difficulties faced by the banks as some of them are still struggling with changes and adjustments to accommodate to Islamic principles due to the complexity of the system.

6.4.3. Perceptions on Market and Liquidity Risk

As part of the perceptions analysis on RM practices in Islamic banks, this section aims to present the findings on market and liquidity risk with 16 constructs. The results are presented in Table 6.10.

Table 6.10: Perceptions on Market and Liquidity Risk

Construct		Frequency	Valid (%)	Mean	Mean Ranking	Standard Deviation
The framework for market risk can accommodate all assets held (such as *Sukuk*, *Salam* etc.)	Disagree	2	7.1	3.82	10	0.77
	Neutral	5	17.9			
	Agree	17	60.7			
	Strongly Agree	4	14.3			
	Total	28	100.0			
The bank sets the objectives and defines criteria for each investment type of profit-sharing instruments (*e.g. Mudarabah, Musharakah etc.*)	Disagree	6	21.4	3.50	13	1.04
	Neutral	7	25.0			
	Agree	10	35.7			
	Strongly Agree	5	17.9			
	Total	28	100.0			
Assessment on overall market risk is based on integrated views taking into account all products and business lines.	Disagree	3	10.7	3.86	8	0.76
	Neutral	1	3.6			
	Agree	21	75.0			
	Strongly Agree	3	10.7			
	Total	28	100.0			
Effective internal controls are in place (*e.g.* adherence to lines of authority and responsibility) to manage market risk.	Strongly Disagree	1	3.6	4.04	1	0.88
	Disagree	1	3.6			
	Neutral	1	3.6			
	Agree	18	64.3			
	Strongly Agree	7	25.0			
	Total	28	100.0			
IT implementation and maintenance is adequate.	Strongly Disagree	1	3.6	3.39	14	0.96
	Disagree	6	21.4			
	Neutral	2	7.1			
	Agree	19	67.9			
	Total	28	100.0			

Construct		Frequency	Valid (%)	Mean	Mean Ranking	Standard Deviation
Procedural guidelines and policy documents are aligned with the board's directions.	Disagree	2	7.1	3.96	4	0.69
	Neutral	1	3.6			
	Agree	21	75.0			
	Strongly Agree	4	14.3			
	Total	28	100.0			
The bank employs appropriate risk measurement techniques that suit the nature, size, and complexity of the business and the availability of data.	Disagree	2	7.1	4.00	2	0.67
	Agree	22	78.6			
	Strongly Agree	4	14.3			
	Total	28	100.0			
The bank ensures that accurate and timely measurements of market risk are performed.	Strongly Disagree	1	3.6	3.93	6	0.81
	Disagree	1	3.6			
	Neutral	1	3.6			
	Agree	21	75.0			
	Strongly Agree	4	14.3			
	Total	28	100.0			
The risk measurement system is responsive and sensitive to the market	Disagree	1	3.6	3.86	8	0.52
	Neutral	3	10.7			
	Agree	23	82.1			
	Strongly Agree	1	3.6			
	Total	28	100.0			
The risk measurement system assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions.	Disagree	2	7.1	3.89	7	0.69
	Neutral	2	7.1			
	Agree	21	75.0			
	Strongly Agree	3	10.7			
	Total	28	100.0			
The risk measurement system has well-documented assumptions and parameters.	Strongly Disagree	1	3.6	3.75	12	0.80
	Disagree	1	3.6			
	Neutral	4	14.3			
	Agree	20	71.4			
	Strongly Agree	2	7.1			
	Total	28	100.0			
There is a mutual agreement with the bank and *Mudarib /Musharakah* partners prior to using the valuation methodologies (to assess the impact of their methods used to calculate and allocate profit).	Disagree	2	7.1	3.32	15	0.67
	Neutral	16	57.1			
	Agree	9	32.1			
	Strongly Agree	1	3.6			
	Total	28	100.0			

Construct		Frequency	Valid (%)	Mean	Mean Ranking	Standard Deviation
The bank ensures its liquidity risk commensurate with the abilities to have sufficient recourse to *Shari'ah* compliant funds to mitigate risks.	Disagree	3	10.7	3.79	11	0.79
	Neutral	3	10.7			
	Agree	19	67.9			
	Strongly Agree	3	10.7			
	Total	28	100.0			
The bank examines all assets and liabilities simultaneously on a continuous basis to ensure a proper balance between funds mobilization and their deployment with respect to yield, risk exposure, etc.	Disagree	2	7.1	4.00	2	0.72
	Neutral	1	3.6			
	Agree	20	71.4			
	Strongly Agree	5	17.9			
	Total	28	100.0			
The bank ensures its tolerance levels on mismatches are timely fixed (for various maturities depending on asset liability profile *etc*.).	Disagree	2	7.1	3.96	4	0.64
	Agree	23	82.1			
	Strongly Agree	3	10.7			
	Total	28	100.0			

As shown in Table 6.10, 60.7% of the respondents agree that 'the framework for market risk can accommodate all assets held (such as *sukuk, salam etc*.)' and 14.3% of the respondents strongly agree with this. However, 7.1% of the respondents disagree that the banks have appropriate tools, procedures and data. This implies that the banks have an adequate structure to cater for all assets held with regards to managing market risk. However, for those banks that do not accommodate all assets, this could be due to certain structural limitations or due to shortcomings in infrastructure or resources. The remaining 17.9% respondents are neutral.

Even though it is important to define objectives and criteria for each financial instrument, only 35.7% of the respondents agree that 'the bank sets the objectives and defines criteria for each investment type of profit-sharing instruments (*e.g. mudarabah, musharakah*)', while 17.9% of the respondents strongly agree with this. 25% of the respondents are neutral and another 21.4% of the respondents disagree with the statement. This is probably due to a lack of directives from the board, which leads to ambiguous and vague policies and procedures spelt out by the management.

Based on the survey results presented in Table 6.10, 75% of the respondents agree that the 'assessment on the overall market risk is based on integrated views taking into account all products and business lines' and 10.7% of the respondents strongly agree with this. In addition, 10.7% of the respondents disagree on this statement. The ability

to assess the overall market risk, which is based on integrated views, might depend on the structure and resources. This might suggest that the banks do not have an adequate structure to help manage the process, especially when it involves high technical expertise. The remaining 3.6% of the respondents are neutral on the statement.

According to the survey results, 64.3% of the respondents agree that 'effective internal controls are in place (*e.g*. adherence to lines of authority and responsibility) to manage market risk lines', while 25% of the respondents strongly agree with this. This implies that, according to the participants, their respective IBs place priority on controls especially with regards to market risks. This is evidenced when the auditor's issue opinions on the effective internal control of the banks. With this statement, the IBs seem to be perceived to be more credible. However, 3.6% of the respondents disagree and strongly disagree, perhaps due to the lack of appropriate tools, procedures and data. The remaining 3.6% respondents are neutral.

As regards to the RM construct, 'IT implementation and maintenance is adequate', as the Table 6.10 shows, 67.9% of the respondents agree with this statement. This indicates that the banks may have adequate technical staff to handle the technology. However, 21.4% and 3.6% of the respondents disagree and strongly disagree respectively that the banks have adequate IT implementations, and this could probably be due to budget constraints or the banks' inability to manage the IT aspect. The remaining 7.1% of respondents are neutral.

As can be seen in Table 6.10, 75% of the respondents agree that 'the procedural guidelines and policy documents are aligned with the board's reporting lines', while 14.3% of the respondents strongly agree with this. This may suggest that the boards, according to the participants, to a certain extent, review the banks' procedural guidelines and policy documents and endorse them. However, 7.1% of the respondents disagree with this construct being effective in their respective IB, while there is no strong disagreement and the remaining 3.6% respondents are neutral with the point.

Based on the findings demonstrated in Table 6.10, 78.6% of the respondents agree that 'the bank employs appropriate risk measurement techniques that suit the nature, size, and complexity of the business and the availability of data' and another 14.3% of

the respondents strongly assert the point. This suggests that the banks have adequate expertise in terms of resources and appropriate structures to accommodate their banking needs. The remaining 7.1% of the respondents however disagree with the statement.

Table 6.10 reveals that 75% of the respondents agree that their 'bank ensures that accurate and timely measurements of market risk are performed' and 14.3% of the respondents strongly agree with this construct. Thus, according to the participants, the banks have adequate resources and skilled staff such as risk experts to perform appropriate and comprehensive risk measurements. However, 3.6% of the respondents each disagree and strongly disagree on the statement, while the remaining 3.6% of the respondents are neutral.

Regarding the 'the risk measurement system is responsive and sensitive to the market' construct, it is shown in Table 6.10 that 82.1% of the respondents expressed agreement and 3.6% of the respondents strongly agreed with this. Perhaps this indicates that the banks have very prudent risk management guidelines and adequate resources to address risk issues timely and appropriately. In addition, 3.6% of the respondents disagree with this construct being effective in their respective IBs, while the remaining 10.7% of the respondents are neutral.

Table 6.10 reveals that 75% of the respondents agree that 'the risk measurement system assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions' and 10.7% of the respondents strongly agree with this. This suggests that the banks have comprehensive systems that can accommodate to manage the overall risk types, which integrate well with the accounting aspect. However 7.1% of the respondents disagree on this. The remaining 7.1% respondents are neutral.

As the findings in Table 6.10 show, 71.4% of the respondents agree that 'the risk measurement system has well-documented assumptions and parameters' in their respective IBs, and 7.1% of the respondents strongly agree with the point. This implies that, according to the respondents, their respective IBs place a high priority on measuring risk by putting in place good and comprehensive risk systems. This also suggests that they have proper day-to-day documentation where policies and

procedures are always kept up-to-date to support operations. However both 3.6% of the respondents disagree and strongly disagree, while the remaining 14.3% respondents are neutral.

Table 6.10 indicates that 32.1% of the respondents agree that 'there is a mutual agreement with the bank and *mudarib*/*musharakah* partners prior to using the valuation methodologies (to assess the impact of their methods used to calculate and allocate profit)' in their respective IB, and 3.6% of the respondents strongly agree with this. This gives the indication that the banks perform transactions in accordance with *Shari'ah* principles, where they ensure that contracts need to specify other financial details besides profit and loss (such as percentage of ownership, roles and responsibilities, and controls among other matters) details to obtain mutual understanding and consent before the transaction takes place. However, 7.1% of the respondents disagree though there is no strong disagreement on this statement, while the remaining 57.1% respondents are neutral. This may imply, according to the respondents, the banks are not being transparent in dealing with their business transactions.

As the results in Table 6.10 depict, 67.9% of the respondents agree that 'the bank ensures its liquidity risk commensurate with the abilities to have sufficient recourse to *Shari'ah* compliant funds to mitigate risks', while 10.7% of the respondents strongly agree with this. To a certain extent, this is always the case considering the IBs nature of operations, which has limited room to manoeuvre and is more susceptible to *Shari'ah* risk. Hence, the banks are perceived to be relatively prudent with regards to managing their liquidity. As the results indicate, 10.7% of the respondents disagree, and the remaining 10.7% respondents are neutral.

According to the results presented in Table 6.10, 71.4% of the respondents agree that 'the bank examines all assets and liabilities simultaneously on a continuous basis to ensure a proper balance between funds mobilization and their deployment with respect to yield, risk exposure, *etc*.' and 17.9% of the respondents strongly agree with this. Besides having prudent risk management in place, according to the respondents this also implies that the banks have a very robust system that is able to accommodate to the complexity of the risk management aspect. However, 7.1% of the respondents disagree, while the remaining 3.6% respondents are neutral.

Based on Table 6.10, 82.1% of the respondents agree that their respective IB 'ensures its tolerance levels on mismatches are timely fixed (for various maturities depending on asset liability profile *etc*.)' and 10.7% of the respondents strongly agree with this. Apart from having full engagement from the top management, this may imply that the banks have adequate and highly skilled risk management experts on board. However the remaining 7.1% of the respondents disagree that the bank ensures its tolerance levels on mismatches are timely fixed.

6.4.4. Perceptions on Operational Risk

This section focuses on the findings established through the questionnaire survey on the perceptions of the participants on their perspective on 'operational risk management' practices dimension in their respective IB with 7 constructs. Table 6.11 shows perceptions of the respondents on the operational risk of the banks.

As can be seen in Table 6.11, 85.2% of the respondents agree that the 'key risk indicators (KRIs) are reviewed regularly' where 18.5% of the respondents assert this strongly. This implies that, according to the participants, their respective banks are very pro-active with regards to managing risks, hence evidencing a strong awareness on risk management. Presumably, this is achieved by updating their staff on changes to risk exposure. However, 7.4% of the respondents disagree that the KRIs are regularly reviewed, but there is no strong disagreement on this statement. The remaining 7.4% respondents are neutral.

The survey results in Table 6.11 reveal that 67.9% of the respondents agree that their respective IBs 'has an IT system to accommodate to the bank's business operations' and 17.9% of the respondents strongly agree with this. As far as IT is concerned, according to the respondents, most banks (especially newly established banks) seem to have IT readiness as their systems comply with the bank requirements. However 3.6% of the respondents strongly disagree with IT adequacy instead. The remaining 10.7% respondents are neutral. Perhaps this is not a concern as the banks have other alternatives, such as having vendors to resort to.

6.11: Perceptions on Operational Risk

Construct		Frequency	Valid (%)	Mean	Mean Ranking	Standard Deviation
Key risk indicators (KRIs) are reviewed regularly.	Disagree	2	7.4	3.96	2	0.76
	Neutral	2	7.4			
	Agree	18	66.7			
	Strongly Agree	5	18.5			
	Total	27	100.0			
The bank has an IT system to accommodate to the bank's business operations.	Strongly Disagree	1	3.6	3.96	1	0.79
	Neutral	3	10.7			
	Agree	19	67.9			
	Strongly Agree	5	17.9			
	Total	28	100.0			
The bank has an IT system to provide adequate check and balance to ensure that controls are in place.	Strongly Disagree	1	3.6	3.93	3	0.86
	Disagree	1	3.6			
	Neutral	2	7.1			
	Agree	19	67.9			
	Strongly Agree	5	17.9			
	Total	28	100.0			
The bank has an IT system to cater for internal risk reporting and decision making.	Strongly Disagree	1	3.6	3.64	5	0.83
	Disagree	2	7.1			
	Neutral	4	14.3			
	Agree	20	71.4			
	Strongly Agree	1	3.6			
	Total	28	100.0			
The bank reduces operational risks by identifying potential negative events and developing appropriate responses.	Disagree	1	3.6	3.93	3	0.60
	Neutral	3	10.7			
	Agree	21	75.0			
	Strongly Agree	3	10.7			
	Total	28	100.0			
Human resources in risk department are adequate and well-trained.	Strongly Disagree	1	3.6	3.50	6	1.04
	Disagree	5	17.9			
	Neutral	4	14.3			
	Agree	15	53.6			
	Strongly Agree	3	10.7			
	Total	28	100.0			

Based on the findings presented in Table 6.11, 67.9% of the respondents agree that 'the bank has an IT system to provide adequate check and balance to ensure that controls are in place' and 17.9% of the respondents strongly agree with this. Thus, according to the participants, this indicates that the banks have a reliable system in

place that allows straight thorough processing without human intervention. However, both the respondents who disagree and strongly disagree make up 3.6% of the respondents each, while the remaining 7.1% respondents are neutral.

As regards to the construct 'the bank has an IT system to cater for internal risk reporting and decision making', the results in Table 6.11 indicate that 71.4% of the respondents expressed agreement, while 3.6% of the respondents strongly agree with this. Thus, according to the participants, to a certain extent, their respective IBs have some internal controls in place especially when most tasks are automated. However, 7.1% of the respondents disagree and 3.6% of the respondents strongly disagree with this. The remaining 14.3% respondents are neutral.

The findings in Table 6.11 reveals that 75% of the respondents agree that their respective bank 'reduces operational risks by identifying potential negative events and developing appropriate responses' and 10.7 % of the respondents strongly agree with this. This may imply that the banks have a business continuity plan in place to accommodate to business needs in the event of a failure in bank operations. However, 3.6% of the respondents disagree on this point and the remaining 10.7% of respondents are neutral. .

The survey results in Table 6.11 reveal that 53.6% of the respondents agree that the 'human resources in risk department are adequate and well-trained' and 10.7% of the respondents strongly agree with this. Thus, according to the participants the banks have very effective training programs besides good recruitment policies. However, 17.9 % of the respondents disagree and 3.6% of the respondents strongly disagree on this. The remaining 14.3% respondents are neutral.

6.4.5. Perceptions on *Shari'ah* Risks

This section focuses on perceptions on *Shari'ah* risk dimensions with 6 statements or constructs, the findings for which are presented in Table 6.12.

As can be seen in Table 6.12, 64.3% and another 10.7% of the respondents agree and strongly agree respectively that their respective IB 'is aware of the potential associated risks to society and the environment especially with regards to the impacts on environment, society, financial conditions and operations'. This implies that the

banks understand that *Shari'ah* risk is detrimental to banking operations hence there is no disagreement on this statement. The remaining 25.1% of the respondents are neutral, perhaps due to a lack of awareness on *Shari'ah* risk exposure.

6.12 Perceptions on *Shari'ah* Risks

Construct		Frequency (valid)	Mean	Mean Ranking
The bank is aware of the potential associated risk to society and the environment (such as its impact on environment, society, financial conditions and operations).	Neutral Agree Strongly Agree Total	7 18 3 28	3.86	5
The bank takes appropriate steps to address the above-mentioned risks (include disclosure of information) before underwriting deals.	Disagree Neutral Agree Strongly Agree Total	1 10 13 4 28	3.71	6
The bank assesses the potential impacts of its methods with regards to profit (i.e. in terms of its calculations allocations.)	Disagree Neutral Agree Strongly Agree Total	1 5 17 5 28	3.93	4
The bank ensures fund providers' interests are taken care off.	Neutral Agree Strongly Agree Total	3 21 4 28	4.04	2
The methods used are mutually agreed between the bank and other stakeholders.	Neutral Agree Strongly Agree Total	5 19 4 28	3.96	3
The bank donates the penalty charges to charity to comply with *Shari'ah*.	Neutral Agree Strongly Agree Total	2 19 7 28	4.18	1

Based on the survey results in Table 6.12, 46.4% of the respondents agree that their respective IB 'takes appropriate steps to address the above-mentioned risks (include disclosure of information) before underwriting deals' and 14.3% of the respondents strongly agree with this. This suggests that the banks have *Shari'ah* governance policies in place to guide them before they act on any deals. However, 3.6% of the respondents disagree with this point, while another 35.7% respondents are neutral.

It is evidenced in Table 6.12 that 60.7% of the respondents agree that their respective 'bank assesses the potential impacts of its methods with regards to profit (*i.e.* in terms of its calculations allocations)' and 17.9% of the respondents strongly agree with this. However, 3.6% of the respondents disagree with that. The remaining 17.9% respondents are neutral. There is no strong disagreement on this statement.

As regards to the construct that 'bank ensures fund providers' interests are taken care off', the survey results in Table 6.12 indicate that 75% of the respondents expressed agreement, while 14.3% of the respondents strongly agree with this. Thus, according to the participants the banks take care of the interest of the stakeholders. However, whether the interests of the minority are taken care off is another issue. It should be noted that the remaining 10.7% of respondents have neutral views. The fact that there is no disagreement on this statement is not unusual, especially when prominent shareholders are involved as, most of the time, their interests are highly taken care off as opposed to other minority stakeholders.

Table 6.12 shows that 67.9% of the respondents agree with the statement that 'the methods used to calculate profit are mutually agreed between the bank and other stakeholders' and another 14.3% of the respondents indicate this very strongly. This may imply that banks conduct their operations in accordance with *Shari'ah* principles, assuming that the banks define the investment methods. As the results indicate, the remaining 17.9% respondents do not commit to this claim. On a similar note, despite the mutual agreement of methods of calculation, sometimes stakeholders are not given the freedom to opt for alternative choices, especially when the banks have limited products to offer. As the results show there is no disagreement on this statement.

Based on the responses depicted in Table 6.12, 67.9% of the respondents assert that 'the bank donates the penalty charges to charity to comply with *Shari'ah*' and 25% of the respondents strongly stress this. Although this may seem like a continuation of the banks public relations strategy, it implies that by donating, banks are actually doing the things that they ought to be doing in their normal course of affairs as part of CSR practice and not just by developing donations as a trend. Giving donations is not only done by IBs but also non-IBs. Meanwhile, 7.1% respondents are neutral and there is no disagreement on the statement.

6.5. SUMMARISING THE FINDINGS OF DESCRIPTIVE ANALYSIS

This section aims to provide further analysis by examining the mean rankings of the constructs for CG and RM dimensions and then also provides mean score rankings of CG and RM dimensions. Thus, this section initially highlights the construct with the highest mean as well as the lowest mean obtained by the constructs from each dimension of CG. Then in the second part of this section, similar highlights are done on RM. Please refer to Table 6.13.

As the presentation of findings in this section on the CG dimension reveal through the constructs, 'the bank appoints a qualified external auditor' shows the highest mean score (mean value of 4.43). The lowest mean score in the 'audit' dimension is indicated by 'the board ensures external auditors have adequate expertise to conduct *Shari'ah* audit' (mean value of 0.339). The rest of the mean ranking for each construct in this dimension can be found in Table 6.5.

With respect to the board, their effectiveness is perceived to be very important as reflected by 'the board monitors management's execution plan' with its highest mean score (mean value of 4.39) in the 'board effectiveness' dimension. The construct 'the roles of Chairman and CEO split' are considered to be the least important by the participants (mean value of 1.11). The rest of the mean ranking for each construct under this dimension can be found in Table 6.2.

The organisational structure, committees and senior management that hold the entities together seem to be seen as the main element that supports the board. The construct 'appropriate structure to assist board in discharging its function is in place' indicates the highest mean (mean value of 4.39) in the 'structure, committees and senior management' dimension while the construct *'Shari'ah* advisors ascertain internal controls and operations of bank's conduct' seems to be considered the least important construct (mean value of 3.43) by the participants. The mean ranking for the rest of the constructs under this dimension can be found in Table 6.3.

In the 'regulatory disclosure and transparency' dimension, financial credibility is crucial in terms of sustaining businesses, hence accounting process are highly regarded by the respondents, as reflected through the construct 'the accounting processes produce reliable information' (mean value of 4.21). The construct 'the bank

discloses the weaknesses of the products' (mean value of 2.79) shows the lowest mean in this dimension. The rest of the mean ranking for each construct under this dimension can be found in Table 6.4.

With respect to policies and procedures, the construct '*Shari'ah*-related strategies and principles are approved by *Shari'ah* advisors' reveals the highest mean score (mean value of 4.18). The lowest mean (mean value of 3.79) was shown by the constructs 'Shari'ah governance framework is comprehensive' and 'the policies and procedures are regularly revised' respectively. The rest of the mean ranking for each construct under this dimension can be found in Table 6.6.

In terms of support and operations, it is also evidenced that the banks are highly dependent on adequate and efficient support and operations as the participants highly regard the construct 'control processes are adequate' (mean value of 3.68). The construct 'the bank has an efficient system to support key business operation' (mean value of 3.36) shows the lowest mean. The rest of the mean ranking for each construct under this dimension can be found in Table 6.7.

Similarly, the construct with the highest mean in each RM dimension is highlighted. In aligning with *Shari'ah* principles, the respondent highly regards that banks comply with *Shari'ah*. This is reflected through the construct 'the bank financing strategies include formal exclusions of any engagement that deals with haram or unlawful goods and services' (mean value of 4.43). The construct 'the bank has appropriate tools, procedures and data used to improve the impairment of loans' shows the lowest mean (mean value of 3.82) in the 'credit risk' dimension. The rest of the mean ranking for each construct under this dimension can be found in Table 6.9.

The construct with the highest mean in general risk management practice dimension 'the controls comply with the regulatory and internal policies and procedures' (mean value of 4.18) reveals that policies and procedures are most important elements in ensuring controls are in place. The construct 'the bank has strong MIS to support the risk management system' shows the lowest mean (mean value of 3.39). The rest of the mean ranking for each construct under this dimension can be found in Table 6.8.

As banks are perceived to be highly ethical, the respondents regard the construct 'the bank donates the penalty charges to charity to comply with *Shari'ah* (4.18) to be

comparatively important among all other constructs in the *Shari'ah* dimension. The construct 'the bank takes appropriate steps to address the above-mentioned[45] risks (include disclosure of information) before underwriting deals' shows the lowest mean (mean value of 3.71). The rest of the mean ranking for each construct under this dimension can be found in Table 6.12.

In ensuring the business, it is also viewed that the respondents highly regard adequate controls to be in place as evidenced through the construct 'effective internal controls are in place (*e.g*. adherence to lines of authority and responsibility) to manage market risk' (mean value of 4.04). The construct 'there is a mutual agreement with the bank and *Mudarib / Musharakah* partners prior to using the valuation methodologies (to assess the impact of their methods used to calculate and allocate profit)' shows the lowest mean (mean value of 3.32). The rest of the mean ranking for each construct under this dimension can be found in Table 6.10.

Table 6.13: Mean Scoring of CG and RM Dimensions

CG Dimensions	Mean Score	RM Dimensions	Mean Score
Effectiveness and efficiency of audit	4.15	Credit risk	4.03
Appropriateness of the structure and committees and effectiveness of the senior management	3.99	Shari'ah risk	3.95
Appropriateness and comprehensiveness of policies and procedures	3.96	General risk management practices	3.94
Board effectiveness	3.82	Operational risk	3.82
Regulatory disclosure and transparency	3.75	Market and liquidity risk	3.81
Efficient support and operations	3.51		

With respect to operational risk, the constructs 'the bank has an IT system to accommodate to the bank's business operations' (mean value of 3.96) score the highest in the operational risk dimension. The construct 'human resources in risk department are adequate and well-trained' shows the lowest mean (mean value of

[45] Potential associated risk to society and the environment (such as its impact on environment, society, financial conditions and operations).

3.50). The rest of the mean ranking for each construct under this dimension can be found in Table 6.11.

After presenting the highest and lowest mean scored constructs under each CG and RM dimensions, the following provides the mean score ranking for CG and RM through dimensions to identify the ranking of dimensions as identified by the responses given by the participants.

6.6. DETERMINING FACTORS OF THE OBSERVED PERCEPTIONS: INFERENTIONAL STATISTICAL ANALYSIS

This section aims at identifying the factors determining the expressed perceptions of the participants on their views on CG and RM practices in their respective IBs by comparing the responses based on different groups of samples through non-parametric test of mean comparison. This is based on the assumption that the responses are affected by four factors: 'location (country)', 'positions' held by the respondent, 'type' and, 'inception year' or the longevity of the IBs. The analysis presented in the following sections describes the perceptions on each construct based on these identified factors by means of the Kruskal-Wallis test, a non-parametric test.

The Kruskal-Wallis test results in Table 6.14 to 6.17 reveal that there is a significant difference in constructs across the 'location', 'positions' held by the respondents, 'nature' and, 'inception year' of the IBs as indicated by the *p*-value or the statistically significant level below a 0.5% significance level.

It should be noted that due to length related limitations, only the statistically significant (at 5% statistically significant level) constructs in relation to any of the identified four factors are presented in the following sections.

6.6.1. Searching for the Impact of Country of Origion on Perceptions Related CG and RM Constructs

The Kruskal-Wallis results in Table 6.14 reveal that three constructs are statistically significant across locations. Although the participants come from six location groups or countries; namely Indonesia, Malaysia, Pakistan, Qatar, Turkey and UK; only four

location groups are taken into consideration, as Pakistan and Qatar do not have an adequate sample size to represent their respective countries.

Table 6.14: KW Test for the Impact of Location on their Perceptions

Construct	Location	N	Mean Rank	Chi-Square	Rank	Asymtotic. Sig
Procedural guidelines and policy documents are aligned with the board's directions.	Turkey	4	20.25	12.207	5	0.032
	UK	3	18.17			
	Malaysia	8	14.00			
	Indonesia	11	10.73			
The risk measurement system assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions.	Turkey	4	21.00	13.020	5	0.023
	Malaysia	8	15.00			
	UK	3	15.00			
	Indonesia	11	10.45			
	Total	28				
The bank examines all assets and liabilities simultaneously on a continuous basis to ensure a proper balance between funds mobilization and their deployment with respect to yield, risk exposure, etc.	UK	3	21.83	13.107	5	0.022
	Turkey	4	19.75			
	Malaysia	8	12.19			
	Indonesia	11	11.32			
	Total	28				

As can be seen in Table 6.14, the three CG and RM constructs that are statistically significant across the four location groups are: 'procedural guidelines and policy documents are aligned with the board's directions', 'the risk measurement system assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions' and, 'the bank examines all assets and liabilities simultaneously on a continuous basis to ensure a proper balance between funds mobilization and their deployment with respect to yield, risk exposure, *etc*.'.

For the statement 'procedural guidelines and policy documents are aligned with the board's directions', the results show a *p*-value (asymptotic value) of 0.032, which is less than the tabular value of 0.05 with Chi-square = 12.207. Turkey shows the highest mean rank with a score of 20.25 followed by the UK at 18.17, Malaysia at 14.00 and Indonesia at 10.73. Thus, according to the participants from Turkey, Turkish IBs attach higher importance to this construct.

As for the statement 'the risk measurement system assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions', the results

show a *p*-value = 0.023 and Chi-square = 13.020. Again, Turkey ranks top with the highest mean score of 21.00 followed by the UK and Malaysia with a similar mean rank of 15.00 each and Indonesia at 10.45.

In relation to the above constructs, the results in Table 6.14 show that Turkey has the highest mean rank; suggesting that the country has better procedural guidelines compared to other countries with good risk measurement system to assess all material risk factors. Perhaps this could be explained by events evidenced through recent developments in local banks in Turkey which began offering Islamic products to rigorously capture the international market. Hence with this mission to achieve, obviously guidelines and policies are one of the priorities that have been taken into consideration in order to ensure that they are aligned with, and conform to, regulatory guidelines.

For the statement on 'the bank examines all assets and liabilities simultaneously on a continuous basis to ensure a proper balance between fund mobilization and their deployment with respect to yield, risk exposure, *etc*.', the test reveals a *p*-value = 0.022, Chi-square = 13.107 with UK obtaining the highest score mean of 21.83 followed by Turkey at 19.75 while Malaysia and Indonesia at 12.19 and 11.32 respectively.

Obviously banks have to ensure that their financial exposure is contained and manageable. With regards to UK, its banks are perceived to have prudent risk management besides strict regulatory directives, especially in terms of the deployment of funds. On a similar note, the UK seems to be taking the lead in coming up with guidelines and is always at the forefront in terms of establishing procedures, rules and regulation on risk management.

Thus, the countries in which the IBs are located, as a control variable, only have a statistically significant impact on these three statements; implying that 'the locality of the IBs' influence the answers given by the respondents only in these cases.

6.6.2. Searching for the Impact of Participants' Position on Perceptions Related CG and RM Constructs

Table 6.15 reveals that six statements or constructs are statistically significant across the two position groups. The position groups are: 'risk officer' and 'non-risk officer', with some positions being unspecified. The Kruskal-Wallis test shows that the unspecified group appears to demonstrate the highest mean rank score. However, as the 'position' level cannot be gauged, this group is excluded in the analysis.

Table 6.15: KW Test for the Impact of Participations' Position on their Perceptions

Construct	Positions	N	Mean Rank	Chi-Square	Rank	Asymtotic. Sig
The bank has clear reporting line	Risk Officer	12	17.75	6.572	2	0.037
	Non-risk officer	14	11.25			
	Not specified	2	17.75			
	Total	28				
Shari'ah advisors ensure adequacy of compliance with legal and regulatory requirements	Risk Officer	12	10.38	7.435	2	0.024
	Non-risk officer	14	16.93			
	Not specified	2	22.25			
	Total	28				
The credit guidelines address credit risk associated with the specific features of Islamic financing contracts.	Risk Officer	12	16.75	6.469	2	0.039
	Non-risk officer	14	11.79			
	Not specified	2	20.00			
	Total	28				
The credit policies and procedures guide towards proper credit assessments.	Risk Officer	12	17.63	7.908	2	0.019
	Non-risk officer	14	11.21			
	Not specified	2	18.75			
	Total	28				
The risk measurement system is responsive and sensitive to the market	Risk Officer	12	15.75	9.559	2	0.008
	Non-risk officer	14	15.07			
	Not specified	2	3.00			
	Total	28				
The risk measurement system assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions.	Risk Officer	12	16.88	8.010	2	0.018
	Non-risk officer	14	14.04			
	Not specified	2	3.50			
	Total	28				

As can be seen in Table 6.15, statement that 'the bank has a clear reporting line' is statistically significant (p = 0.037, Chi-square = 6.572). The group 'risk officer'

shows a mean rank of 17.75 while 'non-risk officer' records a mean of 11.25. This could be due to the nature of jobs in risk management which is highly involved in control and authority levels, and hence the 'risk-officer' is in a better position to assess this.

The statement '*Shari'ah* advisors ensure adequacy of compliance with legal and regulatory requirements' is statistically significant (p = 0.024, Chi-square = 7.435). The group 'non-risk officer' records a mean of 16.93 while the group 'risk officer' has a mean rank of 10.38. Presumably the high mean rank by 'non-risk officer' may mean that *Shari'ah* advisors are well-versed in all areas and not specifically on *Shari'ah* matters only. As for the 'risk-officer', their experiences may have comparatively sound contributions in making better judgements with regards to how they see *Shari'ah* advisors practically do their work.

As can be seen in the results presented in Table 6.15, 'The credit guidelines address credit risk associated with the specific features of Islamic financing contracts' is statistically significant (p = 0.039, Chi-square = 7.908). The group 'risk officer' and 'non-risk officer' score mean values of 16.75 and 11.79 respectively. Apparently, it is quite generic for personnel in the risk area to emphasise that their credit guidelines are adequate and appropriate to support the *Shari'ah* banking business.

'The credit policies and procedures guide towards proper credit assessments' is statistically significant (p=0.019; Chi-square = 7.908). The 'risk officer' group ranks the top with a mean of 17.63 while the 'non-risk officer' records a mean of 11.21. This indicates that proper credit assessment is crucial in day-to-day operations. As such, to ensure business viability, its importance is highly regarded by the 'risk-related officer' group as compared to the 'non-risk officer' group. In fact, the 'risk-officer' themselves are accountable towards the substance of the credit policies.

The statement 'the risk measurement system is responsive and sensitive to the market' is statistically significant where the test results reveal: p = 0.008 and Chi-square = 9.559. Both the 'risk officer' and its counter-part show quite a similar mean rank (15.75 and 15.07). Both groups have similar levels of perceptions on this construct as the IT system is one of the main pieces of infrastructure required to support the

banking business. Although to a certain extent, the 'risk-officer' is more hands-on than the capability of the system.

The construct on 'the risk measurement system assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions' is statistically significant (p = 0.018, Chi-square = 8.010). The mean rank score of group 'risk officer' is slightly higher as compared to the mean score of 'non-risk officer' (16.88, 14.04). Obviously, the 'risk officer' group is in a better position to know whether the system is capable of assessing all the risk factors, failing any of which may put the bank's financial position at stake.

Thus, the position of the respondents, as a control variable, only has statistically significant impact on these six statements; implying that the 'position of the respondents' makes a difference in the answers given by the respondents only in these cases.

6.6.3. Searching for the Impact of Type of IBs on Perceptions Related CG and RM Constructs

As shown in Table 6.16, the Kruskal-Wallis test result reveals that three statements are statistically significant across the different nature of the IBs. The 5 natures (or types) of IBs are: 'full-fledge Islamic Bank', 'Islamic window of domestic conventional bank', 'Islamic financial institution', 'foreign Islamic bank', and 'Islamic window of foreign conventional bank'.

The results show that the statement 'roles of the Chairman and CEO is split' is statistically significant (p = 0.031, Chi-square = 6.943) in which the group 'Islamic window of domestic conventional bank' ranks the top with a mean score = 19.25. The groups of 'full-fledge Islamic bank' and 'foreign Islamic bank' record mean values of 13.11 and 12.50 respectively. The highest mean score obtained by 'Islamic window of domestic conventional bank' could presumably be attributed to the fact that more stringent regulatory requirements are enforced by the authorities on domestic banks that require the Chairman and CEO to have separate functions. Perhaps this could avoid the exertion of power, authority and control by specific individuals.

Table 6.16: KW Test for the Impact of Bank Type on their Perceptions

		N	Mean Rank	Chi-Square	Rank	Asymtotic. Sig
Roles of Chairman and CEO split	Islamic Window of Domestic Conventional Bank	4	19.25	6.943	2	0.031
	Full-fledge Islamic Bank	22	13.11			
	Foreign Islamic Bank	1	12.5			
	Total	27				
The bank has no unresolved *Shari'ah* issues on its lack of standard.	Foreign Islamic Bank	1	18.50	8.289	3	0.040
	Full-fledge Islamic Bank	22	16.32			
	Islamic Window of Domestic Conventional Bank	4	6.25			
	Islamic Finance Institution	1	3.50			
	Total	28				
The credit guidelines address credit risk associated with the specific features of Islamic financing contracts.	Islamic Finance Institution	1	26.50	8.798	3	0.032
	Full-fledge Islamic Bank	22	14.70			
	Islamic Window of Domestic Conventional Bank	4	13.50			
	Foreign Islamic Bank	1	2.00			
	Total	28				

The statement that 'the bank has no unresolved *Shari'ah* issues on its lack of standard' is statistically significant (p = 0.040, Chi-square = 8.289). The 'foreign Islamic bank' ranks top with a mean of 18.50 while the 'full-fledge Islamic bank' records a mean of 16.32 followed by 'Islamic window of domestic conventional bank' (6.25). This may imply that, as far as foreign banks are concerned, they have to be more diligent in complying with the host country's regulations as this may cause licences to be revoked. Hence, being foreign banks, they are more vigilant in keeping the operations effectively flawless.

The statement on 'the credit guidelines address credit risk associated with the specific features of Islamic financing contracts' is statistically significant with p-value = 0.032 and Chi-square = 8.798. The group 'Islamic finance institution' ranks top with a mean = 26.50. This is followed by 'full-fledge Islamic bank' with a mean of 14.70 while the group 'Islamic window of domestic conventional bank' records a mean of 13.50 followed by foreign financial institution with mean 2.00.

Thus, the bank type, as a control variable, only has statistically significant impact on these three statements; implying that 'type of IBs' makes a difference in the answers given by the respondents only in these cases.

6.6.4. Searching for the Impact of Longevity of IB on Perceptions Related CG and RM Constructs

According to Table 6.17, seven statements are significantly different across IBs with four ranges of periods of inception years of the IBs. The IBs are grouped by the inception years: 'before 1990s', '1990s', 'between 2000 to 2006' and, 'between 2007 to 2012'. It seems that group '1990s' always scores the highest mean rank. This could probably be due to it having been long established in the industry thus most of the relevant requirements have already been adhered to. The group 'between 2000 to 2006' always takes the lead, presumably due to the fact that they entered the industry in the period that Islamic finance is more developed, hence a lot of initiatives have already taken place and issues have been addressed.

The statement on 'The bank appoints a qualified external auditor' is statistically significant with *p*-value = 0.040 and Chi-square = 10.046. The group 'before 1990s' ranks at the top with a mean of 22.00 while the group '1990s' shows a mean of 16.60 followed by the groups 'between 2000 to 2006' (13.90) and 'between 2007 to 2012' (9.25).

The construct that '*Shari'ah* governance framework is comprehensive' is statistically significant with a *p*-value = 0.046 and Chi-square = 9.707. Again, the group 'before 1990s' ranks top with a mean of 20.75 followed by groups 'between 2000 to 2006' (16.50), 1990s (11.10) and 'between 2007 to 2012' (9.63).

As for the construct that 'The business strategies define the eligible counterparties', it is statistically significant with *p*-value = 0.044 and Chi-square = 9.774. It seems that group 'before 1990s' always ranks the top with a mean of 20.25. This is followed by the group 'between 2000 to 2006' (14.10), '1990s' (14.00) and 'between 2007 to 2012' (10.94).

Table 6.17: KW Test for the Longevity of Banks on their Perceptions

Construct	Inception Year	N	Mean Rank	Chi-Square	Rank	Asymtotic. Sig
The bank appoints a qualified external auditor.	Before 1990s	4	22.00	10.046	4	0.040
	1990s	5	16.60			
	Before 2007	10	13.90			
	2007-2012	8	9.25			
	Not specified	1	22.00			
	Total	28				
Shari'ah governance framework is comprehensive.	Before 1990s	4	20.75	9.707	4	0.046
	1990s	5	11.10			
	Before 2007	10	16.50			
	2007-2012	8	9.63			
	Not specified	1	25.50			
	Total	28				
The business strategies define the eligible counterparties	Before 1990s	4	20.25	9.774	4	0.044
	1990s	5	14.00			
	Before 2007	10	14.10			
	2007-2012	8	10.94			
	Not specified	1	26.50			
	Total	28				
The bank financing strategies include formal exclusions of any engagement that deals with haram or unlawful goods and services.	Before 1990s	4	19.00	9.872	4	0.043
	1990s	5	14.10			
	Before 2007	10	16.90			
	2007-2012	8	8.50			
	Not specified	1	22.50			
	Total	28				
The credit guidelines address credit risk associated with the specific features of Islamic financing contracts.	Before 1990s	4	20.00	11.501	4	0.021
	1990s	5	13.50			
	Before 2007	10	14.80			
	2007-2012	8	10.50			
	Not specified	1	26.50			
	Total	28				
The risk measurement system assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions.	Before 1990s	4	18.00	9.550	4	0.049
	1990s	5	19.80			
	Before 2007	10	13.65			
	2007-2012	8	11.88			
	Not specified	1	3.50			
	Total	28				

Construct	Inception Year	N	Mean Rank	Chi-Square	Rank	Asymtotic. Sig
The bank is aware of the potential associated risk to society and the environment (such as its impact on environment, society, financial conditions and operations).	Before 1990s	4	13.38	11.274	4	0.024
	1990s	5	18.60			
	Before 2007	10	16.30			
	2007-2012	8	8.69			
	Not specified	1	27.00			
	Total	28				

'The bank financing strategies include formal exclusions of any engagement that deals with haram or unlawful goods and services' is statistically significant with *p*-value = 0.043 and Chi-square = 9.872. The group 'before 1990s ranks top with a mean of 19.00, followed by 'between 2000 to 2006' (16.90), '1990s' (14.10) and 'between 2007 to 2012' (8.50).

Regarding the statement that 'the credit guidelines address credit risk associated with the specific features of Islamic financing contracts' is statistically significant with *p*-value = 0.021 and Chi-square = 11.501. The group 'before 1990s' ranks top with a mean of 20.00, followed by the group 'between 2000 to 2006' (14.80), '1990s' (13.50) and the group 'between 2007 to 2012' (10.50).

'The risk measurement system assesses all material risk factors associated with bank's assets, liabilities and off balance sheet positions' is statistically significant with *p*-value = 0.049 and Chi-square = 9.550. The group '1990s' scores the highest mean, 19.80, followed by 'before 1990s' with a mean of 18.00 and the group 'between 2000 to 2006' with a mean of 13.65. This reflects that banks that operate Islamic banking in the 1990s accommodate better in terms of risk assessment and accounting systems. This may imply that they have fully customised systems, to a certain extent, to cater for their business's needs.

As for the construct that 'the bank is aware of the potential associated risk to society and the environment (such as its impact on environment, society, financial conditions and operations)' is statistically significant with *p*-value = 0.024 and Chi-square = 11.274. The group '1990s' score the highest mean (18.60) followed by 'between 2000 to 2006' (16.30), 'before 1990s' (13.38), and 'between 2007 to 2012' (8.69).

Thus, the longevity of the IBs, as a control variable, only has statistically significant impact on these seven statements; implying that 'year of establishment of the IB' makes a difference in the answers given by the respondents only in these cases.

6.7. EXPLORING THE NEXUS BETWEEN CORPORATE GOVERNANCE AND RISK MANAGEMENT FOR IBs THROUGH THE EXPRESSED PERCEPTIONS

After providing descriptive and inferential statistical analyses, this section attempts to present further inferential analysis to identify potential correlation between CG and RM results. As this section aims to respond to the research question as to whether there is a correlation between these two, which is based on the assumption that better CG performance should result in reduced risk exposure and hence an effective RM. In doing so, statistical methods such as Spearman's Rank and Simple Linear Regression using SPSS was employed. Correlation is used to examine the relationship between two variables (Pallant, 2010). In doing so, proxies are used to represent each CG and RM.

Prior to using the Spearman's Rank correlation analysis technique, the sample is tested to ensure no violations of assumptions of normality, linearity and homoscedasticity.

Spearman's rho is employed to run the test using responses from questionnaires assembled by 28 IB banks. It is felt that this correlation technique suits the analysis best considering the fact that the study is done on a relatively small sample as data accessibility is a major problem encountered during this research process. A correlation is run to establish whether there is a relationship between CG and its dimensions.

This section, hence, comprises four main parts: The first section presents an overall correlation analysis between CG and RM. The second section presents the internal correlation analysis of the CG dimensions which covers: 'board effectiveness'; 'structure, committee and senior management'; 'disclosure and transparency'; 'audit'; 'policies and procedures' and 'support and operations'. The third part analyses the following RM dimensions to provide internal correlation for RM dimensions: 'risk management (general)'; 'credit risk'; 'market and liquidity risks'; 'operational risk'

and '*Shari'ah* risk'. Then the fourth part presents the findings using multiple regression techniques. Finally, the section will present a summary of the analysis to conclude this chapter.

6.7.1. Correlation between CG and RM

As depicted in Table 6.18, the correlation analysis is conducted with Sperman's Rho and Pearson Correlation, both of which indicate that there is a positive correlation between CG and RM. The correlation coefficients are above average which is 0.891 using Spearman's Rank correlation and 0.734 using Pearson's moment-product correlation, evidencing that the relation between the two variables, CG and RM are relatively strong as expected. Table 6.18 also shows that the identified relationship is statistically significant between the variables. This provides evidence for the hypothesis that there should be a positive relationship between CG and RM practices.

Table 6.18: Correlation between CG and RM

			Corp govern	Riskmgt
Spearman's rho	Corpgovern	Correlation Coefficient	1.000	.891**
		Sig. (2-tailed)		.000
		N	28	28
	Riskmgt	Correlation Coefficient	.891**	1.000
		Sig. (2-tailed)	.000	
		N	28	28

Note: (**) Correlation is significant at the 0.01 level (2-tailed).

		Corp govern	Riskmgt
corpgovern	Pearson Correlation	1	.734**
	Sig. (2-tailed)		.000
	N	28	28
riskmgt	Pearson Correlation	.734**	1
	Sig. (2-tailed)	.000	
	N	28	28

Note: (**) Correlation is significant at the 0.01 level (2-tailed).

It should be noted that while the analysis in this section provides evidence for the correlation, it is also important to identify the direction of the relationship, as it is assumed that effective CG practice results in efficient RM practices; and hence the direction of the relationship is expected to be from CG to RM. This is explored in the next chapter.

6.7.2. Correlation between Corporate Governance and its Dimensions

Corporate governance, as widely discussed in the literature, is always associated with financial failures. It is felt in this study, however, that some efforts are needed to identify which dimensions of CG have a significant impact on the latter. In searching for a technique to identify dimensions, a correlation analysis is considered.

The first part explores the correlation based on the perceptions of the respondents on CG and RM in the banks by examining their various dimensions using the analysis tool Spearman's Rank. The following sub-section proceeds with the results of the findings of each dimension, as depicted in Table 6.19; however, only the statistically significant ones are reported.

As can be seen from Table 6.19, there are strong and positive correlations between corporate governance and its dimensions. 'Corpgovern' which is a proxy of corporate governance has a strong correlation with 'support and operations' (r = .809, p = 0.000); 'policies and procedures' (r = .797, p = 0.000), 'audit' (r = .780, p = 0.000), 'board' (r = .751, p = 0.000), 'disclosure and transparency' (r = .548, p = 0.003) and 'structure, committee and senior management' (r = .491, p = 0.008).

Apart from the relationships between 'Corpgovern' and other dimensions, relationships among the dimensions are also observed. As the findings in Table 6.19 show the 'board' is highly correlated with 'support and operations' (r = .706, p = 0.000), 'policies and procedures' (r = .664, p = 0.000) and 'audit' (r = .619, p = 0.000) dimensions. This indicates that board effectiveness requires good support for efficient operations of the bank. There is also a positive correlation between 'board' and 'disclosure and transparency' (r = .573, p = 0.001) as well as between 'board' and 'structure, committee and senior management' (r = .496, p = 0.007).

The internal correlation in Table 6.19 for CG also reveals the relationship between 'structure, committee and senior management' and 'policies and procedures' (r = .685, p = 0.000) indicating that structure is very much responsible for policy comprehensiveness. Similarly, there is a quite a strong correlation between 'structure' and 'audit' (r = .528, p = 0.004) as effective structure is associated with high levels of audit effectiveness. This may imply that management and committees have influence on audit effectiveness. There is also a correlation between 'structure' and 'support and

operations' (r = .413, p = 0.029) and 'structure' and 'disclosure and transparency' (r = .367, p = 0.054).

Table 6.19: Internal Correlation between CG Dimensions

Correlations[c]									
			Corpgovn	Board	Str.,co.& mgt	Disclo.& Tran.	Audit	Pol. & Proce.	Supp. & Op.
Spearman's rho	Corpgovern	Correlation Coefficient	1.000	.751**	.491**	.548**	.780**	.797**	.809**
		Sig. (2-tailed)		.000	.008	.003	.000	.000	.000
	Board	Correlation Coefficient	.751**	1.000	.496**	.573**	.619**	.664**	.706**
		Sig. (2-tailed)	.000		.007	.001	.000	.000	.000
	Structure, committee & manage.	Correlation Coefficient	.491**	.496**	1.000	.367	.528**	.685**	.413*
		Sig. (2-tailed)	.008	.007		.054	.004	.000	.029
	Disclosure & Transparen	Correlation Coefficient	.548**	.573**	.367	1.000	.474*	.544**	.506**
		Sig. (2-tailed)	.003	.001	.054		.011	.003	.006
	Audit	Correlation Coefficient	.780**	.619**	.528**	.474*	1.000	.684**	.687**
		Sig. (2-tailed)	.000	.000	.004	.011		.000	.000
	Policies & Procedures	Correlation Coefficient	.797**	.664**	.685**	.544**	.684**	1.000	.702**
		Sig. (2-tailed)	.000	.000	.000	.003	.000		.000
	Support & Operation	Correlation Coefficient	.809**	.706**	.413*	.506**	.687**	.702**	1.000
		Sig. (2-tailed)	.000	.000	.029	.006	.000	.000	

Notes: (**) Correlation is significant at the 0.01 level (2-tailed); (*) Correlation is significant at the 0.05 level (2-tailed); Listwise N = 28

The relationship between 'disclosure and transparency' and 'policies and procedures' (r = .544, p = 0.003) indicate a positive and significant medium strength relationship. Table 6.19 also reveals the relationship between 'disclosure and transparency' and 'support and operations' (r = .506, p = 0.006) and the relationship between 'disclosure

and transparency' and 'audit' (r = .474, p = 0.011), each respectively indicating medium level strong positive and significant correlations.

The relationship between 'audit' and 'support and operations' (r = .687, p = 0.000) and 'audit' and 'policies and procedures' (r = .684, p = 0.000) gives the indication that reasonably strong support and operations are reflected in audit. Perhaps high levels of audit are also complemented by comprehensive policies and procedures. The results in Table 6.19 also reveals relationship between 'policies and procedures' and 'support and operations' (r = .702, p = 0.000) which to a certain extent, reflect effective policies and procedures facilitate good support and operations of the banks.

6.7.3. Internal Correlations between Risk Management Dimensions

This section focuses on the relationships between dimensions in the RM group. As the results in Table 6.20 shows, there exists strong and positive correlation between risk management and each of its dimensions.

Table 6.20: Internal Correlation between RM Dimensions

			riskmgt	Risk Management (General)	Credit Risk	Market & Liquidity Risk	Operational Risk	*Shari'ah* Risk
Spearman's rho	riskmgt	Correlation Coefficient	1.000	.868**	.804**	.685**	.794**	.605**
		Sig. (2-tailed)		.000	.000	.000	.000	.001
	Risk Management (General)	Correlation Coefficient	.868**	1.000	.830**	.643**	.837**	.639**
		Sig. (2-tailed)	.000		.000	.000	.000	.000
	Credit Risk	Correlation Coefficient	.804**	.830**	1.000	.756**	.727**	.733**
		Sig. (2-tailed)	.000	.000		.000	.000	.000
	Market & Liquidity Risk	Correlation Coefficient	.685**	.643**	.756**	1.000	.653**	.679**
		Sig. (2-tailed)	.000	.000	.000		.000	.000
	Operational Risk	Correlation Coefficient	.794**	.837**	.727**	.653**	1.000	.553**
		Sig. (2-tailed)	.000	.000	.000	.000		.002
	Shari'ah Risk	Correlation Coefficient	.605**	.639**	.733**	.679**	.553**	1.000
		Sig. (2-tailed)	.001	.000	.000	.000	.002	

As can be seen from Table 6.20, there are strong and positive statistically significant correlations between risk management and its dimensions. The proxy of risk management, 'riskmgt' has a strong, positive correlation with 'Risk Management (General)'(r = .868, p = 0.000); 'Credit Risk (r = .804, p = 0.000), Operational Risk (r = .794, p = 0.000), 'Market & Liquidity Risk' (r = .685, p = 0.000), 'Shari'ah Risk (r = .605, p = 0.001).

Apart from relationships between 'riskmgt' and other dimensions, Table 6.20 also indicates relationships among the RM dimensions, which reveals that 'Risk Management (General)' is highly correlated with 'Operational Risk' (r = .837, p = 0.000), 'Credit Risk' (r = .830, p = 0.000) and 'Market and Liquidity Risk' (r = .643, p = 0.000) dimensions. There is also a correlation between 'Risk Management (General)' and 'Shari'ah Risk' (r = .639, p = 0.000).

Table 6.20 also depicts the relationship between 'Credit Risk' and 'Market and Liquidity Risk (r = .756, p = 0.000, 'Credit Risk' and '*Shari'ah* Risk' (r = .733, p = 0.000), 'Credit Risk' and 'Operational Risk (r = .727, p = 0.000), Market and Liquidity Risk' and '*Shari'ah* Risk' (r = .679, p = 0.000) and 'Market and Liquidity Risk', 'Operational Risk' (r = .653, p = 0.000) and 'Operational Risk' and 'Shari'ah Risk' (r = .553, p = 0.002). As can be seen, in each of these cases the correlation is statistically significant, and in most of the cases, they show a relatively strong relationship.

The correlation analysis in this section, hence, provides the relationships among the dimensions (*i.e.* two dimensions at a time) in the respective CG and RM frameworks. An investigation of inter-relationship between CG and RM is carried out through a regression analysis in the following section.

6.7.4. Exploring the Impact of Dimensions of CG and RM through Regression Analysis

This part explores each of the dimensions of CG and RM using a regression technique. Since one of the aims of this study is to gauge the extent of the impact of its dimensions on corporate governance, this research aims to identify which of the variables have effects on CG and RM (being the dependent variable) and thus a further regression analysis is employed. However, before continuing with the

regression analysis, some tests are undertaken to ensure that all the non-parametric assumptions are fulfilled as the sample is tested for data normality using Kolmogorov-Smirnov and Shapiro-Wilk.

6.7.4.1 Determinants of Corporate Governance: Regression Analysis

The analysis in this section uses data obtained from the banks' employees through their responses from the questionnaires. The questionnaires comprises two parts; CG and RM with six and five dimensions respectively. There are 123 constructs in a total of 11 dimensions where each dimension varies in the number of constructs in its set. Each construct is classified under a specific dimension.

The dimension 'board' is made up of 17 constructs; 'structure, committee and senior management' comprises 15 constructs; 'disclosure and transparency', 'audit', 'policies and procedures' and 'support and operations' have 7, 7, 12, and 8 constructs respectively. As such, in the analysis, the CG model comprises seven variables with CG being the dependent variable (DV) and there being six independent variables based on the dimensions.

The second section analyses the five dimensions of RM. Hence, the model comprises six variables which are: 'risk management (in general)'; 'credit risk'; 'market and liquidity risks'; 'operational risk'; and '*Shari'ah* risk' being the independent variables (IV) with RM being the DV.

In order to see whether all these dimensions influence CG and RM respectively, this section proceeds with an analysis of simultaneous multiple regression models. All the independent and dependent variables are continuous where the independent variables (IV) are based on Likert Scales. It should be mentioned that for multiple regression analysis, a non-parametric test is used as the probability of the distribution is not known, the sample is not normally distributed, and there is non-linearity.

The respective regression model for CG and RM is presented as follow:

$$CG = \alpha_1+\beta_1 Board+\beta_2 Structure+\beta_3 Disclosure+\beta_4 Audit+\beta_5 Policies+\beta_6 Support+ \varepsilon_1 \quad (6.1)$$

$$RM = \alpha_2+\beta_7 rg+\beta_8 cr\ \beta_9 mr+\beta_{10} or+\beta_{11} sr\ \varepsilon_2 \quad (6.2)$$

$$Corpgov = \alpha_3+\beta_{12}cg+\beta_{13}rm+\beta_{14}disclosure+\beta_{15}audit+\beta_{16}policies+\beta_{17}support+ \beta_{19}rmgen+\beta_{20}cr+\beta_{21}r+\beta_{22}or+\beta_{23}sr+ \varepsilon_3 \quad (6.3)$$

where α_i: constant; ε_i: error term

Based on the three equations, the estimated CG, RM and the overall Corpgov are obtained. The first equation uses CG as the endogenous variable. It represents the main proxy for CG. The second equation uses RM as the endogenous variable, which represents the main proxy for risk management. The third equation uses Corpgov as the endogenous variable representing the main proxy for overall corporate governance.

Based on the first equation, the estimated CG is obtained. The proposed CG model is based on a framework of corporate governance with 6 dimensions. The dimensions are continuous variables while its constructs are comprised of ordinal variables of Likert Scales and one dichotomous variable (nominal). It should be mentioned that CG is a continuous variable (scale).

Similar constructs apply for risk management and also the same sample is used to check for RM which is the proxy for risk management. Its proposed model is based on a framework with five dimensions, which comprise 56 constructs in total. Similar to CG, each dimension is made up of a set of specific constructs, which vary in number. The dimensions of risk management (general) are made up of 19 constructs; credit risk comprises 11 constructs; and market risk, operational risk, and *Shari'ah* have 15, 6, and 6 constructs respectively. All these constructs comprise ordinal variables of Likert Scales.

Hence based on the proposed model (6.3), there are at least 11 items that might affect the overall corporate governance (Corpgov). The following model is regressed to see to what extent they affect CG. This could be explained by the Table 6.21 (simplified regression table).

Equation (6.1) estimates 6 coefficients of parameters of CG variables. As can be seen in Table 6.21, the results provide a better estimation of the coefficients of parameters and a relatively high goodness of fit with the adjusted R^2 and the coefficient of determination is quite close to the perfect model at about 78%. Thus, the model

presented in this study explains about 78% of the variation observed in the dependent variable, which is quite highly satisfactory.

Table 6.21: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.908[a]	.825	.775	.23927

Note: a. Predictors: (Constant), board, audit, disclosure and transparency, Structure, committee and management, support and operation, policies and procedures

The results of the adjusted R^2 are verified by the results provided through ANOVA as shown in Table 6.22. By dividing the regression sum of squares by the total sum of squares, the same adjusted *R* result is obtained.

Table 6.22: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5.664	6	.944	16.489	.000[b]
	Residual	1.202	21	.057		
	Total	6.866	27			

Notes: a. Dependent Variable: corpgovern; b. Predictors: (Constant), Board, Audit, Disclosure & Transparency, Structure, Committee and Management, Support and Operation, Policies and Procedures

The Table 6.22 also indicates that ANOVA analysis produced highly significant results as the model was fully significant.

Table 6.23: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coef.	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			LowerB	Upper B
1	(Constant)	1.539	.464		3.316	.003	.574	2.504
	Structure, com. & Mgt	-.376	.149	-.353	-2.531	.019	-.685	-.067
	Disclosure & Transparency	.020	.119	.023	.170	.867	-.227	.267
	Audit	.237	.149	.238	1.585	.128	-.074	.547
	Policies & proc.	.328	.158	.327	2.083	.050	.001	.656
	Support & Operation	.407	.099	.623	4.103	.001	.201	.613
	Board	.022	.129	.024	.168	.868	-.246	.289

Note: a. Dependent Variable: corpgovern

Table 6.23 provides the coefficient estimates for the model mentioned through the path analysis by using the multiple linear regression method. As depicted, the model has three dimensions that are statistically significant: 'support and operations' with a coefficient value of 0.623 and *p*-value of 0.001; 'policies and processes' with a coefficient value of 0.327 and $p = 0.05$; 'structure, committee and management' with a 0.353 coefficient value and p = 0.019. It is also noted that 'structure, committee and management' variable has a negative sign which indicates that when this variable increases, CG will decline. The remaining dimensions: 'board', 'disclosure and transparency' and 'audit' are not significant based on the analysis. Thus, these three statistically significant variables or constructs should be considered in defining the determinants of CG level.

As for the regression analysis for the determinants factors of R, the results in Table 6.24 for equation (6.2), identified above, estimates five coefficients of parameters of risk management variables. In general, the results provide a relatively high estimation of coefficients of parameters and a relatively high goodness of fit with the adjusted *R*-Square or the coefficient of determination being quite close to the perfect model with about 67%. Thus the model presented in this study explains about 67% of the variation observed, which is quite highly satisfactory.

Table 6.24: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.855[a]	.732	.671	.26201

Notes: a. Predictors: (Constant), *Shari'ah* Risk, Operational Risk, Market & Liquidity Risk, Risk Management (General), Credit Risk

The result of the adjusted R^2 in Table 6.25 is verified by the results provided through ANOVA as shown in the table below. By dividing the regression sum of squares by the total sum of squares, the same adjusted R result is obtained.

Table 6.25: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4.118	5	.824	11.997	.000[b]
	Residual	1.510	22	.069		
	Total	5.628	27			

Notes: a. Dependent Variable: riskmgt; b. Predictors: (Constant), *Shari'ah* Risk, Operational Risk, Market & Liquidity Risk, Risk Management (General), Credit Risk

The above **ANOVA[a]** table also indicates that ANOVA analysis produced highly significant results as the model was fully significant.

Table 6.26: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	.813	.507		1.604	.123	-.238	1.865
	Risk Management (General)	.721	.207	.893	3.483	.002	.292	1.150
	Credit Risk	.091	.294	.091	.310	.759	-.518	.700
	Market & Liquidity Risk	-.230	.174	-.311	-1.325	.199	-.590	.130
	Operational Risk	-.060	.169	-.083	-.353	.728	-.410	.291
	Shari'ah Risk	.243	.169	.233	1.434	.166	-.108	.594

Note: a. Dependent Variable: riskmgt

Table 6.26 provides the coefficient estimates for the model mentioned through the path analysis by using the multiple linear regression method. As depicted, the model has only one dimension, 'risk management (general)', with a coefficient value of 89.3 and p-value of 0.002, which was statistically significant. The remaining dimensions: 'credit risk', 'market and liquidity risks', 'operational risk', '*Shari'ah* risk' are not statically significant based on the analysis. It is, however, important to state that 'operational risk' and 'market risk' variables have negative signs; indicating that when the disclosure index increases in this case, the global RM disclosure index declines, namely a negative yet insignificant relationship exists.

6.8. CONCLUSION

CG is more often perceived as very high level, thus, in terms of impact and as can be seen from liberal studies, it does not have much to directly influence the banking business operations as opposed to RM. However, based on the empirical results, higher importance is placed on CG than in RM as indicated through the CG dimensions. It is revealed that the effectiveness of audit is paramount to strengthen the framework. However, this could be seen as being highly supported by the appropriate structure, committees and senior management as well as comprehensive policies and procedures, that need to be in place. In fact, the rest of the dimensions such as 'board effectiveness', 'disclosure and transparency', as well as 'support and operations' also affect the CG framework as they do not differ much from 'audit', 'structure, committees and top management' and 'policies and procedures' dimensions in terms of their mean scores.

As for the RM practices, although it seems to be much more regarded as the key aspect in the banking system compared to CG, through its direct impact on banking businesses and operations, the empirical reveals otherwise. Quite similar to CG, all RM dimensions are about the same level in terms of their mean scores. The top three mean scores are indicated by 'credit risk', '*Shari'ah* risk' and 'general risk management practices'. However, it is noted that the results indicate that addressing 'credit risk' is perceived to be the highest priority for the banks as opposed to taking care of *Shari'ah* risk, although upholding *Shari'ah principles* is a distinct mandate as far as IBs are concerned.

Based on statistical analysis, from the perspective of the relationship between CG and RM, these two aspects are perceived as highly correlated. With regards to their respective components, CG and RM are very much dependent on their main components. In the case of CG, it is the 'Support and Operations' dimension that affect CG the most. As for RM, the RM dimension 'risk management (general)' plays a very important role that affects the overall RM.

CHAPTER 7

CONTEXTUALISING THE FINDINGS AND CONCLUSION

7.1. INTRODUCTION

There has been a great deal of discussion on corporate governance (CG) and risk management (RM) following a series of failures of the financial institutions. Institutions, especially banks, are said to be seriously vulnerable when CG procedures and RM are not observed properly.

CG, considered the cause of such crises (Solomon, 2010), and RM, to a certain extent, are always seen as playing similar roles in the system. Boards of directors are blamed (Dionne and Triki, 2005) for their inability to comprehend banking issues and are accused of ignorance, with opponents claiming that their conduct, or lack thereof, is directly responsible for the issues that arise during such crises. However, in a recent study, Adams (2012) disagrees that board is to be blamed, as she sees the problem as more of a regulations and policies issues. Holmstrom and Kaplan (2005) on the other hand, view that it is the legislative and regulatory side that makes for a good governance system and that the culprit for the corporate failures could be 'overregulation'.

To an extent, corporate failure is also associated with RM (Kirkpatrick, 2009), which is usually brought to the public attention as its oversight is claimed to not be adequately performed. RM significantly affects the degree of firms affected by financial crises (Erkens *et al*., 2012). In addition, weak policies and procedures also contribute to failures (Meltzer, 1985) apart from weakness in controls and operations and disclosure and transparency in relation to risk management, which are all brought into the limelight.

Despite the blame that has been placed on CG and RM, initiatives and focuses on these issues have always been of interest in the literature, and matters of how CG and RM can help avoid future crises are widely discussed, such as in Kirkpatrick (2009). Based on their conceptual frameworks, CG and RM have very wide dimensions

respectively. They are similar in the sense that they both comprise of several dimensions (such as the board, the committees, and the senior management) and are supported by their individual operational managements with the resources and infrastructure necessary to undertake operations where transparency and disclosure are observed and regulated through regulatory requirements and audit. Putting this into perspective, these are the dimensions that comprise the respective overall CG and RM.

Some clarity is, therefore, needed to assess the right dimension to improve CG and RM areas in both the banking industry in general and the financial system specifically. This requires the wide aspects of CG to be examined in order to identify which dimensions have significant influence on the overall CG. A similar approach applies to RM, which has been the main agenda in banking practices and has always been highly emphasised due to being perceived as being directly associated with profit.

By narrowing down analysis on the components, *i.e.* on the individual dimensions in CG and RM, this research helps to focus on specific and relevant aspects. In light of this, it is felt that there may be some components, or perhaps just a single aspect, which acts as the main triggering factor that causes financial and corporate failure. Thus, this research aims to identify 'what' in CG and RM are the most influential dimensions that could be given more attention to, instead of the 'how' of addressing the issue. In doing so, this study aimed at exploring CG and RM practices in Islamic banks and also aimed at identifying correlation between the two.

As identified in Chapter 1, this study is an attempt to establish the principles of the CG and RM frameworks. It is important to note that the results may not have high bearings on the overall banking practices considering its limitations. However, "concepts such as risk and corporate governance are social constructs shaped by the contexts they inhibit. As dimensions of the organisational realm, they become operationalised and actionable because they can be formalised and rendered. As such, making risk and corporate governance concepts procedural and analytical enhances their capacity to be managerially actionable" (Bhimani, 2009:3).

Thus, in this vein, in light of providing IBs with a view to develop clearer CG and RM frameworks for the banks, each dimension of CG and RM is examined in detail. It should be noted that CG and RM frameworks used in the study may have duplications and redundancies in their respective dimensions. In practice, this occasionally happens in banks. Thus besides trying to identify the specific areas in CG and RM and their disclosures that affect the overall CG and RM, this research, in view of a lack of clear delineations between dimensions, helps to highlight the areas of concern that are the result of grey areas or unclear lines between CG and RM.

As resources are channelled towards all dimensions, this sometimes creates redundancies in work. As much as the dimensions from these two aspects are concerned, the duplications and redundancies could cause overlaps in CG and RM areas. At some points, the overlapped work may be attributed to the absence of a clear demarcation between the scope of work, which CG and RM fall into. Certain constructs may be better placed under CG, while others may be better under RM.

At some points, an unclear demarcation may even cause conflicts of interest if reporting lines are not carefully taken care off. As stated by Edwards and Clough (2005) in their study on governance and management, clarity on different responsibilities and functions of each roles and, achieving equilibrium between the two, will contribute making the organisation run smoothly. On the other hand, as mentioned by Clark and Urwin (2009:6), in the context of decision making, the overlap in interaction with one another in practice often blurs the boundaries in poorly governed institution such that the issue will accumulate and overlap with one another.

CG and RM are always associated with each other and they are often used interchangeably in discussions (Bhimani, 2009). In retrospect, with regards to issues of financial crises, this has motivated and led this research into exploring the CG-RM relationship. The research uses a conceptual and foundational framework of CG and RM in trying to understand the issues behind their constructs and practical constructs. In general, the research has shown quite an unexpected outcome from what is generally perceived in the literature, as it reveals that initial perceptions are not the same as empirical evidence.

In trying to support IBs to be on par with the conventional banking, this research embarks to establish CG framework and RM practices from their relationship perspective. The findings show that CG and RM are two variables that are correlated with each other and this is how they are generally perceived to be with regards to their relationship. Quite unexpectedly, the findings fail to locate any strong relationship between them, especially from the disclosure approach. The study found that only some dimensions in CG and RM have a high influence on the overall CG and RM while others do not.

Using both the conceptual and empirical components, the study has provided a holistic perspective on the research area by highlighting insights towards improvements in Islamic banking in particular with regards to adopting CG and managing risk. Given the strength of the relationship between CG and RM, this helps to correctly identify the dimension that could increase the effectiveness of CG and RM, hence could empower the focus on what really matters most.

The findings of this study contribute to the literature through its exploration in systemising the disclosed information on CG and RM in Islamic banks and also for establishing the relationship between CG and RM. The study presents empirical evidence based on two approaches: the disclosure approach and the perception approach using primary and secondary data respectively. The primary data is obtained through questionnaires from 28 banks from 6 countries, while the secondary data comprises of 181 annual reports from 57 banks from 15 countries.

The findings empirically evidence that CG is associated with RM: low CG implies poor RM, and *vice versa*. The findings also reveal that the overall CG is always lower than the overall RM. In general, the relationship between CG and RM is quite moderate, at 0.588 based on the disclosure results, but significantly higher, at 0.891 using the perceptions approach. Thus, IB staff articulates a more efficient CG and RM practice as opposed to disclosure; the gap may be explained by the shortcomings in regulations in relation to disclosure as well as cultural norms not enforcing such practices.

In trying to identify the main dimensions in CG and RM that affect them the most, the results between the two approaches are quite dissimilar. The findings from the

disclosure approach, using regression analysis, found that '*Shari'ah* compliance' and '*Shari'ah* governance' dimensions affect CG the most. Based on the questionnaire approach, however, it is revealed that the 'support and operations', 'structure, committees and senior management' and 'policies and procedures' dimensions influence CG with high impact. Hence, the divergence between the primary and secondary data analysis has to be identified in terms of the perceived and disclosed nature of the practices in relation to CG and RM in this aspect of the study also.

As for RM, based on the analysis from the disclosure approach, the study found that 'reporting and disclosure' and 'risk management (control)' dimensions affect RM the most as opposed to the perception approach which reveals that the only dimension that influences RM is 'risk management (general)'. As in the case of CG, the distinctions in the results produced by two different data sets should be stated.

However, it is important to note that based on the study undertaken in a specific period, not all dimensions have a positive effect on CG and RM. Based on the disclosure approach, 'board leadership' has a negative significant impact on CG. This is quite in line with a study by Erkens *et al.* (2012) who highlights how CG may be linked to performance through board conduct. As for RM, the 'market and liquidity risk', and 'credit risk' dimensions have negative effects on RM but these are not significant.

Based on the results presented in the empirical analysis chapters (5 and 6), and as summarised above, the following section aims to provide a critical analysis in further meaning making. The study shows that, with regards to practices, CG is not too far off from expectations, as it seems that CG has been taken quite seriously by the banks, especially by the main market players in the banking industry. In fact, due to its role as being more supervisory in nature, a relatively favourable observation is perceived on the acceptance of CG code recently.

7.2. REFLECTING ON THE FINDINGS OF CG AND RM RELATIONSHIP

This section discusses the findings from both the disclosure and the perception approaches. On the discussion on the former approach, results are based on the level of disclosure of CG and RM that are communicated through the IBs' annual reports, while the discussion on the latter is related to the results that are based on the

respondents' perception as in how the latter view CG and RM in their IBs. Eventually, an attempt is made to establish CG-RM relationship from the findings of both the section, while trying to identify which dimension influences CG and RM the most.

7.2.1. Reflecting on the Findings from Disclosure Analysis

The findings are based on the analysis conducted in Chapter 5, which uses bank and country comparisons. The results indicate that a high CG index attained by the banks or countries does not necessarily mean they attain high RM as well. This is not quite consistent with a study by Drew *et al.* (2005), which views a good CG structure supports RM development. Their study, in elaborating the CG comprehensive structure, comments that with good CG, through areas such as board leadership, structure and support dimensions help to strategize risk management.

Bhat (2008:4), agreeing with Drew *et al.* (2005), mentions that good CG and RM provide the tools and data to help the management better monitor and measure risk, as he says that it will be difficult to obtain risk management without corporate governance.

The findings of the disclosure analysis also reveal that in most cases the overall mean disclosure for CG is comparatively lower than the one for RM irrespective of the type of comparison (*i.e.* either bank-wise or country-wise). Generally, this is triggered by low disclosure in board-related as well as *Shari'ah*-related dimensions for CG. The findings also show that the overall means for CG and RM are higher in bank comparison compared to the country comparison. The overall mean CG disclosure is 0.32 bank-wise compared to 0.25 country-wise and the overall mean RM disclosure is slightly higher at 0.57 bank-wise compared to 0.51 country-wise. In many cases, the disclosures for CG and RM in the bank comparison are higher as opposed to the ones in the country comparison, primarily due to the disparate level of acceptance of CG code and different level of RM practices among the banks themselves thus this affect the overall disclosure for their countries.

7.2.1.1. Reflecting on the findings from bank level comparison

As reported in Chapter 5, no banks managed to score 'very high' CG disclosure, while there is at least one bank, which attained 'very high' RM disclosure. CIMB's 'very

high' RM disclosure is attributed to its key risk management area, perhaps triggered by its very ambitious profit-oriented business, which requires the bank to manage risk prudently in its attempt to ensure high profitability and a good track record for business expansion.

As far as CG is concerned, 'high' is the highest ranking attained by the banks. Three banks are identified to be in the 'high' CG disclosure group while there are 17 banks classified in the 'high' RM disclosure group. The 'high' CG disclosure is accounted for by ABIB (Bahrain), BIMB and KFH, all of which, except for KFH, have a very high score on board-related dimensions[46]. This is attributed to their high score in 'board leadership'; but they score quite low in the '*Shari'ah* compliance' dimension. Quite interestingly, KFH's 'high' CG disclosure is significantly attributed to its impressive *Shari'ah* theme[47] contributed by its '*Shari'ah* compliance' and 'ethics' disclosure.

With respect to RM, the IBs in the 'high' RM disclosure group include: EIIB, HLIB, RHB, Al Baraka, Asya, ADIB, Affin, BLME, ABCID, Hilal, Khaleeji, Ithmaar, Al Rajhi, Al Inma, and QIB. Most of the banks are main market players and perhaps this explains the high emphasis on RM. However, based on a study by Perignon and Smith (2010), both investors and creditors may not necessarily benefit from increased information disclosure, as their study on market risk disclosure shows that VaR forecasts were debatable as its quality was excessively conservative. In general, these banks seem to have good disclosure on RM structure too. However, it is worth to mention that the main difference between these banks is also mainly contributed by their disclosure in the 'audit' and 'risk management (committee)' dimensions.

The 'moderate' CG disclosure is accounted for by CIMB, RHB, BISB, JDIB, and JIB while the 'moderate' RM disclosure group is represented by Gatehouse, Al Jazira, Al Falah, BISB, As Salam, Capinnova, Eskan, IIAB, IBB, Al Arafah, KuveytTurk and JIB. Most of the banks in the 'moderate' CG index disclosure group achieve almost full scores in the 'board theme' but scored very low in the '*Shari'ah* theme', especially in '*Shari'ah* compliance'. This contradicts with a study by Hassan (2009),

[46] Which comprise of 'board composition', 'board leadership' and 'board meetings' dimensions.
[47] Shari'ah-related dimensions which comprise of 'Shari'ah governance' and 'Shari'ah compliance' dimensions.

who claims that IBs offer products that are not in violation of any *Shari'ah* principles. JDIB and JIB however, score quite modest in 'board-related dimensions', while CIMB scores very low in '*Shari'ah* compliance'. Banks in the 'moderate' RM disclosure on the other hand, attain a low score in 'audit'. KFH and KuveytTurk for instance, despite having very impressive scores in all other dimensions of RM, only manage to have 'moderate' RM disclosure, as those scores are highly affected by their low score in 'audit' dimension.

The 'low' CG disclosure is accounted by Ithmaar, Khaleeji, BNI Sharia and HLIB while the 'low' RM disclosure is accounted for by Emirates, QIIB, IBQ, Bujr and Rayan. The findings reveal that the 'low' CG disclosure group, like most banks in other groups, is contributed by the 'very low' *Shari'ah* disclosure. HLIB and Ithmaar, for instance, attain very low scores in '*Shari'ah* compliance' and '*Shari'ah* governance' respectively, as opposed to their 'very high' disclosure in board-related dimensions, while Khaleeji scores 'very low' in the 'nomination and remuneration (NR) committee' dimension.

Banks in the 'low' RM disclosure group also attain 'very low' in 'audit' disclosure. Emirates, IBQ, Bujr, Rayan and Kuwait International do not have any disclosure in 'audit', and this could probably be due to the audit areas not being fully developed yet. In the case of QIIB and QIB, the 'low' audit disclosure could be attributed to high staff turnover as well as inadequate skilled resources as reflected in the board composition.

The 'very low' CG disclosure is accounted for by 41 IBs within the sampled IBs, in which As Salam, EIIB, Al Baraka, Affin are among them, while the 'very low' RM disclosure group is represented by 18 banks. In general, banks in the 'very low' CG disclosure group such as Al Baraka (Turk), Asya, As Salam, Affin, ADIB, and BLME have 'very low' disclosure in the board-related dimensions. QIIB for instance, reveals a very little amount on board matter. Asya, Al Baraka (Turk) and KuveytTurk on the other hand, do not have *Shari'ah* disclosure at all. This, to a certain degree, seems to agree with a statement by MIFC (2010) that sees the banks' action as trying to avoid offending secularist sensibilities.

For banks in the 'very low' RM disclosure group, such as Faisal (Egypt), Boubyan, Meezan, Muamalat, Tadamon, Shah Jalal, JDIB, Jadwa, JIB, DIB, Al Baraka, AI Islami, Faisal, Kuwait International, Al Baraka (Sudan), BNI, Al Shamal, and BSM, their 'very low' RM disclosure is highly affected by their low score in 'audit' disclosure (between 0.11 and 0.31). In the case of Al Baraka (Sudan) and Al Shamal, disclosure on the overall RM (committee and control) dimensions is as good as absent. Perhaps this is also attributed to their inadequate resources. On another note, the 'very low' RM disclosure could also relate to performance as Williams (2001), in his study, mentions that competition encourages firms to reduce disclosure as performance reaches a certain level.

7.2.1.2. Reflecting on the findings from country level comparison

As the results demonstrated, No countries are grouped in the 'very high' or 'high' CG disclosure group as 'moderate' is the highest ranking disclosure attained in CG. As for RM, the highest classification attained is 'high', accounted for by Malaysia, Turkey and UK.

Perhaps Malaysia's 'high' RM disclosure is consistent with its efforts to strengthen its Islamic banking position globally. According to Dusuki and Abdullah (2006), Islamic banks in dual systems often must compete with conventional banks that are established and must thus increase customer perceptions. However, this position is quite controversial as Malaysian IBs are often viewed as offering Islamic deposits that are not free of interests and pegged to conventional deposits, while at the same time offering very limited products based on profit-loss sharing (Beck *et al.*, 2013).

As a hub for Islamic finance; Malaysia is able to harness its position to tap Middle Eastern market segments through prudent risk management. Perhaps, this is also triggered by its concerns for higher financial gain. By utilising transparency, this could help attract bigger market segments. This is reflected in its risk-averse banking policies spelt out comprehensively through its annual report.

As for UK and Turkey, their 'high' RM disclosure is mainly attributed to their high score in the key risk management area. The UK, undoubtedly, for many obvious reasons, has insurmountable privileges in terms of managing risk, and reporting and disclosure. Turkey on the other hand, has adopted stringent strategies in providing IB

products through which limited the expansion so that control can be possible. This could be due to the recent initiatives and incentives to promote Islamic banking.

For the 'moderate' classification, Malaysia is the only country in this CG disclosure group, while Bahrain and Saudi Arabia account for the 'moderate' RM disclosure. Malaysia's CG disclosure score (0.62), however, is quite modest despite achieving almost a full score in the board-related dimensions. The full score in the dimensions could be due to the country's political culture, through which IBs, similar to their conventional counterpart, are highly regulated through measures and government intervention. This is supported by Wilson (2009), as he sees that Islamic finance is encouraged in Malaysia through legislation. This is consistent with the opinion developed by Gourevitch and Shinn (2005), who see CG as shaped by the laws of the place where it operates. Specifically, the powers and rights of the shareholders and managers are all defined through local laws (Gourevitch and Shinn, 2005). In other words, the political economy and political culture of a country shapes CG through the banking guidelines. In fact, in their study to examine disclosure, Karamanou and Vafeas (2005) agree that policy makers may be able to improve the system by using legislation to allow for good corporate governance.

Nevertheless, Malaysia's CG disclosure is adversely affected by dimensions such as *Shari'ah*-related and ethics. The country does not fare well in *Shari'ah* compliance but comparatively better in *Shari'a*h governance. The weak *Shari'ah* compliance for Malaysia seems to be in line with a study by Chong and Liu (2007), which claim that IBs in Malaysia are almost the same as conventional banking. In their study examining IBs on *Shari'ah* compliance, they claim that IBs are often perceived as merely pegging their products to interest rates rather than offering actual interest-free products. Perhaps one of the factors affecting this could be explained by the absence of mandatory *Shari'ah* audit. This has been highlighted by Shafii *et al.* (2010) who state that *Shari'ah* compliance audit is needed so that *Shari'ah* practice is undertaken properly.

For RM, to a certain extent, Bahrain has provided necessary risk management-related structures reasonably well in a detailed manner consistent in an effort to strengthen Islamic banking's presence in their country. However, other reasons that may pull the score down could be the inadequate or inappropriate resources or infrastructures that

are not in place. Together with Saudi Arabia, Bahrain scores very high in key risk areas. As for Saudi Arabia, its aims to penetrate the niche market might take longer. Perhaps this is due to lack of transparency triggered by the ownership structure that does not allow banks to impose certain rules in risk management.

Unexpectedly, findings also show that Bahrain and Jordan account for the 'low' CG disclosure group, while Qatar, UAE and Pakistan account for the 'low' RM disclosure group. The 'low' CG disclosure attained by Bahrain is affected by the 'nomination and remuneration committee' dimension and other dimensions such as 'Shari'ah governance', 'board meeting' and 'Shari'ah compliance'. Although Bahrain is seen as the main player in establishing guidelines and procedures, its initiatives in improving CG may need more time, and perhaps this could be attributed to inherent or structural issues, such as the political structure, the business model adopted by the banks, or the internal governance issue. Most countries with the 'low' CG disclosure do not have good board-related disclosure.

The disclosure performance of Jordan and Bahrain could also be influenced by other factors such as the banks' ownership structure and the type of investments that the banks are involved in. Jordan has been very serious in trying to prioritise CG by placing the task to improve CG in the national agenda. However, it might need more time to improve, especially in areas such as documentation and reporting, as it has just adopted the CG mission quite recently. This is consistent with the view from Tapanjeh (2006) who specifically mentions in his study the government's initiatives in enhancing CG and performance. Despite all this, the low disclosure could be attributed to *Shari'ah*-related issues, such as lacking in initiatives to streamline *Shari'ah* guidelines.

As far as RM is concerned, the RM disclosure scores for Qatar, UAE and Pakistan are very much affected by their 'low' audit disclosure. In addition, the 'low' RM disclosure of these countries is also accounted for by 'low' disclosures in both the 'risk management practices' and 'reporting and transparency' dimensions. Perhaps this could be associated with qualifications and experience, as based on a study by Dionne and Triki (2005) having a director with tertiary education is an important determinant in risk assessment.

As the results show, the majority of the countries are in the 'very low' disclosure group. In general, this is attributed to inadequate regulatory framework to enforce disclosure or absence of legal framework to support IBs. This could also due to political or social sensitivities. For most of the 'very low' CG disclosure group, the countries' poor CG score can be generalised as having a 'very low' *Shari'ah*-related disclosure. Other reasons include low disclosure in 'mission' and 'board composition'. As far as CG is concerned, Qatar, Pakistan and UAE have very poor score in board-related dimensions. To a certain extent, board independence is affected by board composition (John and Senbet, 1998). Specifically, as there are more external directors, the board may be seen as more independent (John and Senbet, 1998). The 'board composition', 'board leadership' and 'structure, committee and senior management', as well as 'ethics' dimensions are just around 0.01. However, Qatar recently, is seen as adopting the CG code very diligently as reflected in its mission statements.

As for Indonesia, UK, Saudi Arabia, and Kuwait, their 'very low' disclosure performances are mainly contributed by '*Shari'ah* compliance' and to a certain extent owe much to the 'very low' disclosure in the 'ethics' dimension. In addition, for Kuwait, disclosure on ethics could not be observed.

There are seven countries in the 'very low' RM disclosure group and Bangladesh, Jordan, Yemen, Egypt, Kuwait, Indonesia are among them. Similar to the result for bank comparison, most of these countries have a very high disclosure in their key risk areas, but not quite in the audit dimension. For countries such as Bangladesh, Sudan, and Egypt, the low disclosure could be due to problems of 'low' scores in the 'reporting and documentation' dimension. This could also be the case for some Middle Eastern countries such as Kuwait. For Yemen and Sudan, the reporting on disclosure could be attributed to having inadequate skilled manpower. Williams (2001) supports this statement, as he says that as more intellectual resources actually coincides with there being less disclosure. Kuwait on the other hand, is not relatively ambitious in providing disclosure and reporting area. Perhaps, this only occurs at the discretion of the majority of the shareholder (to disclose). In other words, it depends on the nature of the ownership structure of banks, as some banks have a family-ownership structure.

7.2.1.3. Summary of disclosure analysis on banks and country level comparisons

The preceding section reveals that most banks do not have the same level of disclosure for both their CG and RM. In general banks' CG level is always lower than their RM's disclosure level. However, there are cases when some banks do attain higher disclosure in CG than in RM. This could probably be due to the IBs' lack of professional skill in risk management practices (Hassan and Dicle, 2005).

In general, the CG disclosures for banks are highly influenced by board-related areas such as 'board composition' and 'board leadership. In a similar vein, viewing CG as a crucial task for strategic management of the bank, Maingot and Zeghal (2008) perceive disclosure of CG as highly dependent on bank size. From their analysis, larger banks have higher disclosure. In addition to that, Pathan (2009) posits limited boards positively affect bank risk-taking.

Generally most of the banks in the 'low' and 'very low' CG disclosure groups have 'very low' disclosure in the 'board' dimension. This is consistent with Eng and Mak (2003), who view that disclosure is influenced by the board as ownership structure and board composition all affect disclosure levels.

In general, irrespective of their disclosure groups, the banks have a poor score in *Shari'ah*-related and 'ethics' dimensions. Quite often, the 'high' RM disclosure is attributed to the key risk management area. It is also noted that most banks in the 'moderate', 'low' and 'very low' RM disclosure groups have comparatively low scores in 'audit' dimension as opposed to the key risk management area.

The findings also reveal that even if the bank's CG and RM are in the same disclosure group, the mean for CG tends to be lower than the mean for RM[48]. In terms of number of banks, the 'low' and 'very low' CG disclosure groups have more banks as compared to the similar disclosure groups of RM. Similarly, there are fewer banks in the 'high' and 'moderate' CG disclosure groups compared to their RM counterparts, of which, the latter has quite a balanced number in each disclosure category[49].

[48] For example, ABIB and BIMB have both their CG and RM in the 'high' disclosure group but the mean for their CG (0.793 and 0.767 respectively) are lower than the RM's (0.858 and 0.888 respectively).

[49] The findings show that CG has only 3 banks in the 'high' disclosure group as compared to RM which has 17 banks in the same disclosure classification. There are 5 banks in the 'moderate' CG

Based on the country comparison, it is found that the majority of the countries under survey are still weak in terms of their CG. As such, 'moderate[50]' is the highest CG disclosure obtained despite the Islamic moral economy's essentialisation of 'good Islamic governance' based on Islamic norms.

In concluding, it is important to note that as theory and evidence suggest, disclosure facilitates opening up a company's access to capital markets their shares more attractive to current and prospective investors by reducing information-gathering costs (Bhimani, 2009). Thus, not only Islamic CG principles are not essentualised, the financial values of these institutions may have affected by their low disclosure scores. To expand on this, RM disclosure helps reveal how effective their RM is, while CG plays a subtler role (Bhat, 2008).

7.2.2. Reflecting on the Findings from Perception based Analysis

The findings from perception analysis are based on the 'mean scores' achieved by the RM constructs in all the CG and RM dimensions. Based on the findings from the perception analysis in Chapter 6, the highest mean among all the CG dimensions is mainly obtained from the 'audit' dimension. This is followed by the 'board effectiveness', 'structure, committees and senior management', 'policies and procedures', 'disclosure & transparency' and 'support and operations' dimensions (ranked by means of the constructs in the individual dimension).

As can be seen in the results, the perception on the construct that 'the bank appoints a qualified external auditor' records the highest mean. As a matter of fact, almost all the constructs in this dimension obtain equally high means (shown in Chapter 6, Table 6.5); reflecting that audit is the basis and, is an essential process of corporate governance. This is supported by other literature such as a study by Cohen *et al.* (2002:1) that tries to relate the effects of CG on the audit processes. Audit is viewed as forming a part of the corporate governance structure of which, it acts as the monitoring device (Cohen *et al.*, 2002).

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disclosure group as compared to 12 banks in the same level of disclosure for RM. The findings reveal that the majority of the banks (41) are in the 'very low' CG disclosure group as opposed to only 18 banks in the same levels of disclosure for RM.

[50] Only one country obtains 'moderate' disclosure. The remaining 14 countries have 'low' disclosure of which 12 of them have very 'low' disclosure. As opposed to RM, 3 countries have 'high' disclosure, followed by 2 countries which account for 'moderate' while 10 countries are in the 'low' disclosure group of which 7 of them have 'very low' disclosure.

The findings also illustrate the importance of board effectiveness. As shown in the perceptions on the 'board's effectiveness' dimension, the board's high involvement is highly anticipated, as nearly 50% of the respondents indicate their strong agreement with the construct 'the board monitors management's execution plan'. This signifies high expectation on the board being hands-on in strategic planning (Chapter 6, Table 6.2).

Nonetheless, 'structure, committees and senior management' undoubtedly play an important role in the institutions, as reflected in the perceptions on the dimension 'the appropriateness of the structure and committees and effectiveness of the senior management' (Chapter 6, Table 6.3). The construct 'appropriate structure to assist board discharge its function is in place' is highly regarded as 100% of the responses agree with this construct. For the constructs such as '*Shari'ah* advisor ensure contracts, fatwa, executions and policies comply with *Shari'ah*' and '*Shari'ah* advisors have appropriate skill sets and experience' and 'the bank has clear reporting line' are also perceived to be highly important.

The perceptions on 'the appropriateness and comprehensiveness of policies and procedures' dimension reveals the importance of documentation and standardisation (Chapter 6, Table 6.6). Nearly 90% of the responses agree with '*Shari'ah*-related strategies and principles approved by *Shari'ah* advisors' construct. Similarly, the perceptions on 'regulatory disclosure & transparency' dimension is highly regarded (Chapter 6, Table 6.4), as more than 92% of the respondents agree with the construct 'the accounting processes produce reliable information (*e.g.* for investors and strategic decision making)'. This could be supported by the perception on the dimension 'efficiency of support and operations' when it reveals that infrastructure plays a relatively important role in supporting CG, as evidenced in the construct 'control processes are adequate' which denotes that 67% of the respondents agree with this statement (Chapter 6, Table 6.7). Nonetheless quite a significant percentage of the respondents do not agree with this construct, which can be attributed to inadequate resources to support the bank.

With regards to the risk management aspect, the findings show that perceptions on 'credit risk' dimension attain the highest means, which is followed by the perceptions on 'general risk management practice', '*Shari'ah* risk', 'market and liquidity risk' and

perceptions on ‘operational risk’ dimensions (ranked by means of the constructs in the individual dimension).

Based on the perceptions on ‘credit risk’ dimension, 100% of the respondents agree with the construct that ‘the bank financing strategies include formal exclusions of any engagement that deals with *haram* or unlawful goods and services’ (see Chapter 6, Table 6.9). As far as IBs are concerned, perhaps this pushes the fact that *Shari’ah* compliance is highly regarded. In supporting *Shari’ah* principles, policies and procedures also play a significant role to ensure the take-off. It is also revealed that the ‘general risk management practice’ is important. As such, more than 96% of the respondents agree with the construct that ‘the controls comply with the regulatory and internal policies and procedures’ (Chapter 6, Table 6.8).

Being the institutions that offer Islamic products, it is highly expected that the general rules of *Shari’ah* are fully complied with. The findings also illustrate that more than 92% of the respondents agree with the construct ‘the bank donates the penalty charges to charity to comply with *Shari’ah*’, as indicated by the perceptions on the ‘*Shari’ah* risk’ dimension (Chapter 6, Table 6.12). This however, contrasts with a study by Vinnicombe (2010), in which some countries actually have relatively low compliance with *Shari’ah* requirements as he claims that IBs do not follow the AAOIFI's requirements, such as upholding Islamic principles like ‘*zakah*’, very well. In fact, to a certain extent, *zakah* is regarded a tax burden (Ghoul, 2011).

With regards to the ‘market and liquidity risk’ dimension, it is shown that nearly 90% of the respondents agree that ‘effective internal controls are in place (*e.g.* adherence to lines of authority and responsibility) to manage market risk’ (Chapter 6, Table 6.10). However, about 10% do not agree with this construct, which could be attributed to inadequate resources to ensure internal controls. This could also be related to the perceptions on ‘operational risk’ dimension, as the findings indicate that about 85% of the respondents agree that ‘the bank has IT systems to accommodate to the bank’s business operations’ but the remaining 15% do not agree with the construct (Chapter 6, Table 6.11). This could be triggered by the absence of an appropriate infrastructure to support the business. In short, RM hinges on adequate resources to support the operations.

It is noted that the results of the perception approach may be influenced by several factors. The following section proceeds according to the empirical results from Chapter 6. It further identifies the constructs that are significant to CG and RM.

7.2.2.1. Reflecting on the findings by Kruskal-Waliss test

It is noted that, although the findings from the perception anaylysis are generally consistent with the literature, this study reveals that the responses could be biased as they may be influenced by at least four factors such as locality (country), position of the respondents, and the nature and inception date of the IBs. In contextualising the results from the perception approach, the Kruskal-Wallis (KW) test is employed to compare the results from many groups of samples which are independent from each other. In this case, the samples are grouped by location (countries), position, and type and inception year of the IBs. It is revealed that some constructs are perceived differently by the respondents as they are influenced by the above mentioned criteria.

As evidenced from the results, Turkey ranks top followed by UK, Malaysia, and Indonesia in the following constructs: 'procedural guidelines and policy documents are aligned with the board's directions' and 'the risk measurement system assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions'. The highest means obtained by Turkey in the above constructs reflect that this could possibly be due to the country's strategy to broaden its investor base and diversify financing resources, especially in Islamic finance. As usual, procedures and guidelines, as well as comprehensive risk management systems, have been the pre-requisites prior to the implementation of banking operations.

When the samples are grouped based on the respondents' positions, the findings show that responses from 'non-risk officers' are slightly different to ones from the risk officers. In general, the responses from the 'risk officers' show higher means in the following six constructs: 'the bank has a clear reporting line', '*Shari'ah* advisors ensure adequacy of compliance with legal and regulatory requirements', 'The credit guidelines address credit risk associated with the specific features of Islamic financing contracts', 'The credit policies and procedures guide towards proper credit assessments', 'the risk measurement system is responsive and sensitive to the market'

and ‘the risk measurement system assesses all material risk factors associated with a bank’s assets, liabilities and off balance sheet positions’.

Generally, personnel in the risk-related portfolios are well-versed than those who are not in the risk-related portfolio. Thus sometimes, the former seems to be more risk averse than the latter. The findings, however, show that ‘risk officers’ reveal higher mean scores, as opposed to ‘non-risk officers’. Perhaps the former’s own experience in the bank overrules the norm as their responses are based on their very own working experiences in the bank. Hence a high perception on the above constructs could have been triggered by their good working experience in the bank.

With regards to the other sample groups, the findings, which are based on the sample group ‘type of institution’ highlight three significant constructs. It is revealed that the ‘Islamic window of domestic conventional bank’ prefers to have a ‘split role between the chairman and the CEO’ based on their highest mean score (19.25) as opposed to other institution types. It is viewed that separating the two roles allows for a check and balance system to be in place (Blackburn, 1994). Conversely, Alam and Shah (2013) see that duality is actually beneficial to risk as directors may be able to make decisions in the best interest of the banks while simultaneously being the CEO and being able to such decision making.

As for the ‘foreign Islamic banks’, they seem to be more efficient with regards to following standards. This is reflected through the highest mean obtained in the construct ‘they do not indicate any unresolved *Shari’ah* issues’. With regards to unresolved issues, IBs, similar to the conventional banks, are very closely linked to credits. In this respect, the findings show that ‘Islamic financial institutions’ and ‘full-fledged Islamic Bank’ have very good credit guidelines that feature *Shari’ah* financing contracts as indicated by their highest mean scores in this construct. On this note, the findings may be supported by Hassan (2009) who mentions that a difference exists between national banks and foreign banks when referring to risk assessment and analysis.

This study highlights seven significant constructs with regards to IBs’ establishments. The result from the sample group that is grouped according to the ‘inception year’ show that banks that were established ‘before 1990s’ have better setup in place thus

they are better in terms of readiness. This is evidenced from the high mean scores in the following constructs: 'the bank appoints a qualified external auditor', '*Shari'ah* governance framework is comprehensive', 'the business strategies define the eligible counterparties', 'the bank financing strategies include formal exclusions of any engagement that deals with unlawful goods and services' and 'the credit guidelines address credit risk associated with the specific features of Islamic financing contracts'.

The above implies that long established banks could have prepared them to operate in Islamic banking environments, as they have progressed through longer milestones. Perhaps newer banks may need more time to be able to be at the current position of the old banks ('before 1990s'). In fact, as far as risk management is concerned, banks that were established in '1990s' have better risk management practices, which can be explained by Power (2004) opines that risk management became a more prominent issue in organizations following the mid-1990s. This is evidenced through the significance of the following constructs: 'the risk measurement system assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions' and 'the bank is aware of the potential associated risk to society and the environment (such as its impact on environment, society, financial conditions and operations)'.

Maybe these banks are better because they have the appropriate systems in place, which are already customised to accommodate with the IBs operations. Perhaps the much older banks are still using old infrastructure and thus cannot cope with the new banking requirements. On the other hands, the newer banks might need more time to set up the infrastructure. Hence, the older and newer banks are not quite ready to cater for the banking requirements, ***vis***-à-***vis*** its resources, apart from the structure, policies and procedure, and other infrastructure.

7.3. REFLECTING ON CORRELATIONS BETWEEN CG AND RM

The findings from both disclosure and perception analyses were subjected to further analysis through correlation and regression analyses. A correlation analysis is performed to examine the CG and RM relationship, while a regression analysis is

performed to analyse further the results to identify how much CG and RM can be explained by each of their dimensions.

7.3.1. Reflecting on the Correlation Results in Disclosure Analysis

Based on the analysis using the bank comparison data, it is found that not all dimensions have a high effect on CG and RM. The correlation between the dimension 'board composition' has the highest correlation (0.794) with CG. The dimension 'mission' (0.696), 'board leadership' (0.686), 'Shari'ah governance' (0.676), the 'ethical business' (0.647) and 'nomination committee (0.632) dimensions also denote high correlations with CG. 'Shari'ah compliance' (0.591) and 'board meeting' (0.477) however, do not seem to impose a great impact on CG.

The findings reflect that board composition is very crucial as it helps IBs to effectively steer the banks; their effectiveness has a high influence on CG (John and Senbet, 1998). This is to ensure a mix of skills and expertise to govern effectively (Edwards and Clough, 2005). The dimension 'mission', 'board leadership', '*Shari'ah* governance', 'ethical business' and 'nomination committee' dimensions are also perceived as important. The 'mission' is seen as very significant as it represents the starting point from which banks collectively agree on the organisations goals and objectives (Cohen *et al*., 2010). This is in contrast with a study by Aebi *et al*. (2011, 5), which claims that a shared understanding of CG generally does not have to be in the shareholders' best interests. As for the dimensions '*Shari'ah* compliance' and 'Board meeting', they do not seem to have a great impact on CG.

With correlation is employed to analyse risk management's dimensions, the findings reveal that the dimension 'risk management control' (0.684), 'risk management committee' (0.676), and 'reporting' (0.654) have a great impact on RM. As for other dimensions such as 'credit risk' (0.544), audit' (0.540), 'market liquidity risk' (0.461) and 'other risks' (0.421), they have about an average impact on RM.

The findings reflect that respondents highly perceive 'risk management control', 'risk management committee' and 'reporting' as crucial for RM. Perhaps the high score on 'risk management control' can be explained by a study on the determinant of bank risk-taking by Anderson and Fraser's (1999), which examines managerial ownership's

impact on risk-taking, states that the management, rather than the shareholders. are the ones responsible for setting the bank's risk structure.

The dimension 'Credit risk', surprisingly, is not highly correlated with CG. This is quite in contrast with Switzer and Wang's (2013) study, which mentions that CG and 'credit risk' are significantly associated. 'Audit', 'market and liquidity risk' and 'other risks' are perceived to have mild effects on RM.

It is found that not all dimensions have a high effect on CG and RM. Using regression analysis '*Shari'ah* compliance' dimension is able to explain 36% of corporate governance in IBs while '*Shari'ah* governance' dimension explains 17.4%. the 'reporting' dimension explains 52% of RM. The dimension 'risk management control' explains 31.2%

7.3.2. Reflecting on the Correlation Results on Perception Analysis

It is found that not all dimensions have a high effect on CG and RM. Based on the perception analysis using correlation, the dimension 'supports and operations' has the highest correlation (0.809) with CG, followed by 'policies and procedures' (0.797), 'audit' (0.780), 'board' (0.751), 'disclosure and transparency' (0.548) and 'structure, committee and senior management' (0.491) dimensions.

These findings reflect that respondents highly regard that resources and infrastructure support the IBs' operations. This dependency, nevertheless, is also highly dependent on the adequacy and comprehensiveness of the banks' policies and procedures. To ensure the check and balance, audit is expected to play its role and this has to be mandated by the board as the latter was assumed to be effectively steering the bank. The responses, however, do not view that disclosure and transparency, especially in terms of reporting, as highly important (as reflected in their correlation to CG). Similarly, the findings indicate that the 'structure, committees and senior management' do not play a key role in IBs.

With regards to risk management, the same tool is used to examine which of its dimension influence RM the most. The findings reveal that the dimension 'risk management (general)' has the highest correlation (0.868) with RM, followed by

'credit risk' (0.804), 'operational risk' (0.794), 'market and liquidity risks' (0.685) and '*Shari'ah* risk' (0.605) dimensions.

The findings reflect that respondents perceive that risk management practice, in general, plays a key role in managing risk. The practice seems to be highly dependent on credit risk as well as operational risk. However, it seems that 'market and liquidity risks' is quite moderate in terms of influencing RM. As for '*Shari'ah* risk', its effect on RM does not seem to be that influential on RM.

7.3.3. Summary of Correlations Results

The results from both the disclosure and perception analysis on correlation are found to be quite different. Based on the means shown in the results, the disclosure approach highlights that the board-related dimensions are the most important element in CG. This is evidenced both in banks as well as in country comparisons, as shown in Table 8.1, which summarises the findings. Maybe this could be explained by the fact that good board composition and effective leadership provide the strength to charter the direction of the IBs. The dimensions 'risk management (control), 'risk management committee' and 'reporting' seem to be comparatively more important than other dimensions of risk management, both from the disclosure as well as from the perception approaches.

As shown in Table 8.2, the results based on the perception analysis indicate that the construct 'supports and operations' is one that affects CG level the most, followed by 'policies and procedures'. Perhaps this may have an element of bias as the responses are influenced by factors such as locality, position of the respondents, types and inception year of the IBs. However, these results also signify that good CG is mainly attributed to 'adequate resources and infrastructure in place'. In fact, the respondents also perceive that IBs that have good CG are always accompanied by 'sound and comprehensive policies and procedures in place to support the operations'. As far as respondents' perceptions are concerned, 'structure, committees and senior management' does not play significant role in CG. Similar perception is evidenced in 'disclosure and transparency' dimension.

Table 7.1: Correlations Results Based on Disclosure Approach

	Bank Comparison	Significant Level (Standard coefficient)	Country Comparison	Significant Level (Standard coefficient)
CG	Board composition	.794 (0.000)	Board composition	.962(0.000)
	Mission	.696 (0.003)	Board leadership	.950 (0.000)
	Board leadership	.686 (0.000)	Nomination & remuneration committee	.897 (0.000)
	Shari'ah governance	.674 (0.000)	Ethics	.822 (0.000)
	Ethics	.647 (0.000)	Mission	.806 (0.000)
	Nomination & remuneration committee	.632 (0.000)	*Shari'ah* governance	.732 (0.002)
	Shari'ah compliance	.591 (0.000)	*Shari'ah* compliance	.680 (0.005)
	Board meeting	.477 (0.000)	Board meeting	.595 (0.019)
RM	Risk management control	.684 (0.000)	Risk management control	.928 (0.000)
	Risk management committee	.676 (0.000)	Reporting	.905 (0.000)
	Reporting	.654 (0.000)	Risk management committee	.878 (0.000)
	Credit risk	.544 (0.000)	Other risk	.714 (0.003)
	Audit	.540 (0.000)	Credit risk	.680 (0.005)
	Market & liquidity risk	.461 (0.001)	Audit	.668 (0.006)
	Other risk	.421 (0.002)	Market & liquidity risk	.644 (0.010)

Table 7.2: Correlation Results Based on Perception Analysis

CG	Significant Level (Standard coefficient)	RM	Significant Level (Standard coefficient)
Support & operations	.809 (0.000)	Risk management (general)	.868(0.000)
Policies & procedures	.797 (0.000)	Credit risk	.804 (0.000)
Audit	.780 (0.000)	Operational risk	.794 (0.000)
Board effectiveness	.751 (0.000)	Market & liquidity risk	.685 (0.000)
Disclosure & transparency	.548 (0.003)	*Shari'ah* risk	.605 (0.001)
Structure, committee & management	.491 (0.008)		

7.4. REFLECTING ON THE FINDINGS ON REGRESSION ANALYSIS

The results on regression analysis demonstrate that not all dimensions have a high effect on CG and RM. As summarised in Table 8.3, the regression analysis results based on the disclosure approach show that '*Shari'ah* compliance' and '*Shari'ah* governance' are statistically significant. They explain 36% and 17.4% respectively. It

should be noted that the 'board leadership' dimension has a negative relationship with CG. Similarly, for risk management, when the same tool is used to examine the RM dimensions, the 'reporting and disclosure' and 'risk management control' are significant; explaining 52% and 31.2% of the RM while the other dimensions do not indicate any significance on RM. The 'market and liquidity risk' and 'credit risk' indicate a negative relationship with RM.

Table 7.3: Regression Analysis: Disclosure and Perception Analyses

	Disclosure Analysis	**Significant Level (Standard coefficient)**	**Perception Analysis**	**Significant Level (Standard coefficient)**
CG	*Shari'ah* compliance	0.001 (36%)	Support & operations	0.001 (62.3%)
	Shari'ah governance	0.098 (17.4%)	Structure, committee & management	0.019 (-35.3%)
	Board Leadership	Not significant, negative relationship	Policies & procedures	0.001 (32.7%)
RM	Reporting & disclosure	0.001 (52%)	Risk management (general)	0.02 (89.3%)
	Risk management control	0.027 (31.2%)	Market & liquidity risk	Not significant, negative relationship
	Market & liquidity risk	Not significant, negative relationship	Operational risk	Not significant, negative relationship
	Credit risk	Not significant, negative relationship		

From the perception approach, the 'support and operations' dimension explains 62.3% of corporate governance in IBs. This is followed by 'structure, committee and senior management' and 'policies and procedures', which explain 35.3% and 32.7% of CG. The 'structure, committee and senior management', however, show a negative relationship. In this approach, the board does not have any impact on CG, which is quite inconsistent with a study by Hermalin and Weisbach (2001), which mentions that board composition does not affect performance. Based on their study, the board size has a negative effect on the firms' performance. For risk management, the findings reflect that 'risk management (general)' explains 89.3% of RM in IBs. Other

dimensions do not seem to explain the variation in RM as the findings do not show any significant results. However, it is noted that 'market and liquidity risks' and 'operational risk' have negative effects on RM.

7.5. CRITICAL REFLECTIONS

The results and analysis presented in this study found that the relationship between CG and RM is relatively unexplored. As observed in the literature, CG and RM have been pervasively discussed not just specific to financial crises but also in general. However, it is noted that in the period of post financial crises, the resurgence of CG and RM discussions has been intensified as the latter is perceived to be the triggering factor that is linked to a series of failures. Apart from financial crises and corporate failures, CG is generally discussed in the literature in relation to performance, regulations, disclosure, board and reporting to name a few.

Going back to the relationship between CG and RM, Bhimani (2009) talks about the minimal amount of coverage between CG and RM which he also relates this in the context of management accounting. To this extent, this study has not managed to link to any previous study with respect to the CG-RM relationship as no papers have been found discussing such a relationship. Given the significance of developing a comprehensive CG and RM framework for banking practices, this study, through literature and theoretical foundations, explores CG and RM in trying to examine the CG-RM relationship with the objective of identifying weaknesses in each of their dimension by examining the particular aspect that explains CG and RM the most.

With regards to disclosure, it is noted that corporate voluntary disclosure has been the focus of an increasing amount of attention in recent years (Chau and Gray, 2002:247). Forker (2012) for instance, mentions that board composition and internal control play a role over managerial remuneration, where this is reflected through disclosure (on financial statements). Janadi et al. (2013) also highlights the importance of CG in relation to disclosure based on their study on companies on the Saudi Stock Market. They mention that board composition, CEO duality, audit quality, and board size are among the significant factors that have significant contribution towards disclosure.

In conclusion, it is important to note that CG and RM disclosure is a matter of regulative bodies to enforce such practices in the financial and corporate sectors as well as the political economy and political culture of the respective countries.

However, in the countries where Islamic finance has a reasonable size, political culture is away from being democratic to be able to produce a good corporate governance structure in general, and in particular for Islamic banks. Therefore, 'poor' disclosure results emerged in this study has to be considered and understood within this particular context.

7.6. THEORETICAL REFLECTIONS

In exploring the theoretical concepts from both perspectives of conventional and Islamic corporate governance, it is found that agency theory is more pervasive in the practice of Islamic banks. ICG, in theory, is perceived to be skewed towards adopting stakeholder theory. However, this is quite contradictory to the empirical evidence produced in this study. Based on the outcome of this study, it seems that IBs do not differ much from the conventional banks in terms of their CG framework and risk management practices. Despite upholding *Shari'ah* principles, which are the most distinguishing feature of ICG, the research reveals that IBs generally have very low *Shari'ah* compliance and *Shari'ah* governance. As such, it seems that in the everyday practices of the financial world, there is hardly much difference in terms of ICG and CG. Both models are generally based on agency theory although in principle ICG is more aligned towards stakeholders theory.

As for the larger policy model, as the results of ICG and IRM disclosure and perception analyses show, the practice seems to be more oriented towards the shareholders model than the stakeholder model. Thus, the Anglo-Saxon model seems to more prevalent despite the fact that ICG is expressed within the '*tawhidi*' worldview of being closer to the European model of stakeholders. The results provide evidence for the essentialisation of shareholders, as issues related to shareholders are presented with further care as compared to other issues.

The observed 'social failure' as termed by Asutay (2007, 2012) seems to be prevalent in the area of ICG in the sampled Islamic banks in terms of failures in disclosing the necessary information but also in essentialising shareholders' interest as the disclosed

information shows, regardless of how small the score is. Thus, 'back to basics' should be considered as an important public policy call for Islamic financial institutions and banks in encouraging them to operate within the parameters of Islamic values including structuring and strategizing their corporate governance and risk management practices and in particular the disclosure issues related to both the dimensions.

7.7. LIMITATIONS AND FUTURE RESEARCH

As mentioned earlier, is the main limitation in this study has been the difficulty in gathering effective primary data through questionnaire survey; the similar limitation can be mentioned for the secondary data through annual reports. Perhaps lack of co-operation faced in the data gathering process from most of the financial institutions is due to data confidentiality, especially on CG area (to support the perception approach). Furthermore, they are not abided by law to adhere to such requests. As such, the research has limited choice with regards to choosing the statistical research methods, as it barely surpasses the minimum requirements to employ certain methods and tools.

Ideally, a more supportive initiative is needed from the financial institutions for research of this genre to be able to at least contribute to mainstream research. Should the accessibility for further to data was possible, this research might have been able to provide a clearer picture on the level of CG and RM being practiced in the IBs. It is quite discouraging that despite the efforts put into gathering data, this initiative was not quite supported by the people in the field.

Nonetheless, it is important to note the limitation to the study which recognises that Islamic banks may not necessarily have developed good practices in disclosing their practices both in corporate governance or risk management. Apart from some ontological reasons for this, Islamic banking is a practice that is rather young with a steep learning curve in front of it. In fact, the macro regulative environment in most of the Muslim countries where Islamic banking prevails should also be considered as one of the reasons as to why Islamic banks may fail to disclose and establish a transparent governance mechanism.

This research is aimed at exploring CG and RM, in view of issues on corporate failures, from the perspective of Islamic banking development. The study aims to establish a CG and RM relationship, which requires that these two areas be jointly examined. By examining CG and RM through their relationship, overlapping areas can be avoided through a clear demarcation of related issues. This is important as this joint exploration of CG and RM could be empowered to focus on what matters most in the frameworks.

Moving forward, it is viewed that future research should consider widening the dimensions of CG and RM in trying to develop a more robust and comprehensive framework. It should be noted that the scope of the current study is based on developed frameworks of CG and RM. Based on its conceptual framework of CG, the *Shari'ah*-related dimension has proven to be a significant dimension which could support IBs in terms of upholding Islamic principles. As for RM, the 'reporting and disclosure' and 'risk management controls' dimension are the most crucial, thus initiatives towards transparency and ethicality are highly observed as aligned with the *Shari'ah*. It is felt that the dimensions of CG and RM can be further enhanced by introducing more dimensions into the current frameworks.

Therefore, future research might consider incorporating aspects such as organisational structure, strategic planning, succession planning and, business continuity into the framework through relevant dimensions to make the framework more robust and comprehensive. It is felt that issues in IBs mostly revolve around transparency and a shortage of skilled human resources. By identifying the appropriateness of the organisational structure (which could be reflected in clear reporting lines), issues such as transparency and disclosure could be addressed. As for succession planning, the inclusion of this area should help identify issues on inadequate human resources while retaining and attracting talented and skilled workers. Furthermore, the incorporation of the area on strategic planning may help the banks address issues on board oversight which could help the banks strategize their banking business and operations. As for the business continuity area, this will help banks establish business plans in the event of disruptions in their operations.

In addition, the dimensions that the current study is based on could be further developed by identifying and establishing more constructs in the relevant dimensions

to strengthen and improve the comprehensiveness of the dimension itself. Although this might be quite a hurdle in terms of data gathering, the results could be worthwhile.

On another note, it is felt that future research should consider establishing the fundamentals of the principles of the CG and RM framework. This could possibly allow for the convergence of Islamic and conventional banking. Through convergence, it is hoped that the mandate to uphold Islamic principles by Islamic banks will not be jeopardised. This could possibly be done through research based on a country case study approach in countries that have dual banking systems.

7.8. EPILOGUE

This research aimed at exploring the state of and relationship between CG and RM in IBs. In trying to identify the causes for financial crisis, it is important to analyse the issues in CG and RM by examining the framework through their respective dimensions. In trying to respond to its research questions, as stated in Chapter 1, this research employs two different approaches: disclosure and questionnaire survey, to obtain secondary and primary data respectively. Based on the analyses on the two types of datasets, it is revealed that CG and RM are correlated.

With this, the research has fulfilled its aim and objectives as stated in its research questions (Chapter 1). The results from both the conceptual and empirical perspectives have provided a holistic view on the research area, providing an insight on different aspects of CG and RM with regards to how the banks adopt CG and RM and to what extent their practices are in line with their communications. The research also provides some insights on how CG and RM are perceived and to what extent they are observed as reflected through disclosure as stated in the IBs' communication.

To a certain degree, this study has managed to find a gap between practices and communications, as revealed in the findings, because what is communicated could be different from what is claimed and practiced. Besides, relevant dimensions should be given more emphasis with regards to enhancing overall frameworks in the future.

APPENDIX

APPENDIX 1: QUESTIONNAIRE

GENERAL INFORMATION

Locality / Location:	……..
Position:	……..
Nature of the bank/financial institution:	☐Full-fledged Islamic Bank ☐Islamic Window of Domestics Conventional Bank ☐Islamic Financial Institution ☐Foreign Islamic Bank ☐Islamic Window of Foreign Conventional Bank
The Inception Year of the Bank:	…….

PART 1: CORPORATE GOVERNANCE

BOARD OF DIRECTORS (BOD)

(Please tick (x) in the appropriate box)

1. The roles of the Chairman and CEO are split, i.e. the roles are held by two people.
   - □ Yes
   - □ No

For all the statements below, please express your opinion on the following statements (SD: strongly disagree to SA: strongly agree).

No.	Statement	SD	D	N	A	SA
1.	The bank has an appropriate number of independent directors.	□	□	□	□	□
2.	The board:					
	a) is not over-powered by the Chairman.	□	□	□	□	□
	b) provides an adequate oversight function.	□	□	□	□	□
	c) has clear missions and vision.	□	□	□	□	□
	d) has diverse background and expertise to steer the bank.	□	□	□	□	□
	e) has strong credentials.	□	□	□	□	□
	f) is ethical and transparent in carrying out their job functions.	□	□	□	□	□
	g) oversees the strategic planning process.	□	□	□	□	□
	h) monitors the management's execution of the corporate and business plan.	□	□	□	□	□
	i) reviews with the management on the codes of conduct and ethics that are incorporated into the bank's strategy and business operations.	□	□	□	□	□
	j) assesses resources and prioritises key operational matters of the bank	□	□	□	□	□
	k) ascertains that there are no misleading financial statements;	□	□	□	□	□
3.	The board has effective succession planning (*i.e.* well-articulated strategies with assessment and benchmarking) to help decide on a future leader.	□	□	□	□	□
4.	The board convenes for regular meetings effectively.	□	□	□	□	□
5.	The bank adopts an effective system in board approvals on decision making.	□	□	□	□	□
6.	The board recognises the need to develop and strengthen their governance skills in light of technological developments and changing environments to become better leaders and change agents.	□	□	□	□	□

STRUCTURE, COMMITTEES AND SENIOR MANAGEMENT

No.	Statement	SD	D	N	A	SA
1.	An appropriate structure (e.g. committees, Shariah board/advisory) is in place to assist the board in discharging its functions.	☐	☐	☐	☐	☐
2.	The bank has clear reporting lines as reflected in the organisational chart.	☐	☐	☐	☐	☐
3.	Shariah advisors:					
	a) are impartial and / or independent of the bank.	☐	☐	☐	☐	☐
	b) are resourceful and efficient.	☐	☐	☐	☐	☐
	c) are easily accessible by the bank.	☐	☐	☐	☐	☐
	d) have appropriate skill sets and experience.	☐	☐	☐	☐	☐
4.	The role of Shariah advisors include to:					
	a) ensure that contracts, fatwa on transactions, sequence of execution, and policies are in accordance with Shariah principles.	☐	☐	☐	☐	☐
	b) actively monitor the business and investment activities of the bank to safeguard shareholders' interests.	☐	☐	☐	☐	☐
	c) ascertain the internal controls, efficiency of financial operations, and the effectiveness of the bank's conduct.	☐	☐	☐	☐	☐
	d) ensure the adequacy of compliance with legal and regulatory requirements and policies in all aspects of business and its strategy.	☐	☐	☐	☐	☐
	e) perform product approval.	☐	☐	☐	☐	☐
5.	The bank has competent senior management to oversee business implementation.	☐	☐	☐	☐	☐
6.	The senior management:					
	a) develops strategic plans for board review;	☐	☐	☐	☐	☐
	b) oversees enforcement on policy implementation;	☐	☐	☐	☐	☐
	c) articulates the bank's missions and vision effectively to all staff.	☐	☐	☐	☐	☐

DISCLOSURE AND TRANSPARENCY

No.	Statement	SD	D	N	A	SA
1.	The bank conforms to the highest international standard and practices for financial and non-financial reporting and disclosure.	☐	☐	☐	☐	☐
2.	Bank accounting standards are harmonised with prudential standards.	☐	☐	☐	☐	☐
3.	The accounting processes produce reliable information (e.g. for investors and strategic decision making).	☐	☐	☐	☐	☐
4.	The bank discloses:					
	a) methods to calculate profits;	☐	☐	☐	☐	☐
	b) the weaknesses of the products.	☐	☐	☐	☐	☐
5.	The bank has no unresolved Shariah issues on its lack of standard.	☐	☐	☐	☐	☐
6.	Information disclosure and transparency is appropriately done (timely and adequate).	☐	☐	☐	☐	☐

AUDIT

No.	Statement	SD	D	N	A	SA
1.	Audit and / or review are done by independent auditors.	☐	☐	☐	☐	☐
2.	The bank appoints a qualified external auditor.	☐	☐	☐	☐	☐
3.	The board:					
	a) reviews the scope of audit.	☐	☐	☐	☐	☐
	b) are aware of the highlighted audit findings.	☐	☐	☐	☐	☐
	c) ensures external auditors have adequate expertise to conduct Shariah audit.	☐	☐	☐	☐	☐
4.	Auditors ensure the truth and fairness of the financial statements.	☐	☐	☐	☐	☐
5.	Regular audit and compliance assessments continuously take place.	☐	☐	☐	☐	☐

POLICIES AND PROCEDURES						
No.	**Statement**	**SD**	**D**	**N**	**A**	**SA**
1.	Shariah governance framework is comprehensive.	☐	☐	☐	☐	☐
2.	Shariah-related strategies and principles are:					
	a) approved by Shariah advisors.	☐	☐	☐	☐	☐
	b) incorporated in the business strategy	☐	☐	☐	☐	☐
3.	The business strategies define the:					
	a) eligible counterparties;	☐	☐	☐	☐	☐
	b) nature of approved Shariah compliant financing.	☐	☐	☐	☐	☐
4.	The bank has comprehensive policies and procedures to support compliance with board policy.	☐	☐	☐	☐	☐
5.	The policies and procedures:					
	a) address Shariah matter.	☐	☐	☐	☐	☐
	b) address legal matter.	☐	☐	☐	☐	☐
	c) ensure guidance on details of the bank's business.	☐	☐	☐	☐	☐
6.	The policies and procedures are:					
	a) effective.	☐	☐	☐	☐	☐
	b) regularly revised.	☐	☐	☐	☐	☐
	c) communicated across the board.	☐	☐	☐	☐	☐

SUPPORTS AND OPERATIONS						
No.	**Statement**	**SD**	**D**	**N**	**A**	**SA**
1.	Control processes are					
	a) adequate.	☐	☐	☐	☐	☐
	b) effective.	☐	☐	☐	☐	☐
2.	The bank has					
	a) adequate resources to support the bank's operations.	☐	☐	☐	☐	☐
	b) an efficient system to support key business operations.	☐	☐	☐	☐	☐
	c) appropriate systems to help with complying to Shariah in terms of products and services.	☐	☐	☐	☐	☐
	d) a good reporting, documentation, and records management system.	☐	☐	☐	☐	☐

	e) effective information and communication technology to ensure the dissemination of information to the management.	☐	☐	☐	☐	☐
	f) put in place adequate and appropriate trainings for senior management and all employees.	☐	☐	☐	☐	☐

PART 2: RISK MANAGEMENT

RISK MANAGEMENT (GENERAL)						
No.	**Statement**	**SD**	**D**	**N**	**A**	**SA**
1.	There is an adequate board risk oversight function.	☐	☐	☐	☐	☐
2.	There is a robust risk management framework that is aligned with Shariah principles in place.	☐	☐	☐	☐	☐
3.	Risk assessment is incorporated into all business decision making.	☐	☐	☐	☐	☐
4.	The board					
	a) understands risk management as the key drivers of success in corporate strategies.	☐	☐	☐	☐	☐
	b) ascertains CEO and senior management are fully engaged with risk management.	☐	☐	☐	☐	☐
	c) ensures independent risk management and business functions.	☐	☐	☐	☐	☐
	d) ensures policies and procedures in relation to risk adopted by the management is appropriate and comprehensive.	☐	☐	☐	☐	☐
	e) oversees the management's implementation of policies and procedures of risk is followed and effective.	☐	☐	☐	☐	☐
	f) knows whether the management has appropriately responded to risks.	☐	☐	☐	☐	☐
	g) monitors the potential risk in the bank's culture and incentive system.	☐	☐	☐	☐	☐
5.	The board reviews with the management:					
	a) risk appetite and other risk-related matters.	☐	☐	☐	☐	☐
	b) risk management policies and procedures.	☐	☐	☐	☐	☐
	c) reports on risk-matter from the audit, legal departments and regulators.	☐	☐	☐	☐	☐
6.	Shariah advisors are aware of the risk exposure that arises from different jurisdictions in different locations.	☐	☐	☐	☐	☐

7.	The bank has	☐	☐	☐	☐	☐
	a) a dedicated unit to undertake the risk management process to manage each type of risk.	☐	☐	☐	☐	☐
	b) competent and well-trained personnel to undertake risk management functions	☐	☐	☐	☐	☐
	c) strong MIS to support the risk management system.	☐	☐	☐	☐	☐
8.	The controls					
	a) take into account the integrity of the risk management process.	☐	☐	☐	☐	☐
	b) comply with the regulatory and internal policies and procedures.	☐	☐	☐	☐	☐

CREDIT RISK						
No.	**Statement**	**SD**	**D**	**N**	**A**	**SA**
1.	The financing strategies for various instruments comply with Shariah.	☐	☐	☐	☐	☐
2.	The bank financing strategies include formal exclusions of any engagement that deals with *haram* or unlawful goods and services.	☐	☐	☐	☐	☐
3.	The credit guidelines address credit risk associated with the specific features of Islamic financing contracts.	☐	☐	☐	☐	☐
4.	The list of all allowable types of transaction are kept up-to-date and communicated to the relevant staff.	☐	☐	☐	☐	☐
5.	The credit policies and procedures:					
	a) guide towards proper credit assessments.	☐	☐	☐	☐	☐
	b) address loan charge-offs and recoveries.	☐	☐	☐	☐	☐
	c) consider current collateral values where applicable in the recovery process.	☐	☐	☐	☐	☐
6.	The bank					
	a) is able to recognize potential credit exposure at different stages of financing.	☐	☐	☐	☐	☐
	b) is aware of the relevant internal and external factors that may affect loan collectability.	☐	☐	☐	☐	☐
	c) has specific methods used to validate models for credit risk assessment and credit risk management tools (e.g. stress tests and back tests).	☐	☐	☐	☐	☐
	d) has appropriate tools, procedures and data used to improve the impairment of loans.	☐	☐	☐	☐	☐

MARKET RISK and LIQUIDITY RISK						
No.	**Statement**	**SD**	**D**	**N**	**A**	**SA**
1.	The framework for market risk can accommodate all assets held (such as Sukuk, Salam etc).	☐	☐	☐	☐	☐
2.	The bank sets the objectives and defines criteria for each investment type of profit-sharing instruments (e.g. Mudarabah, Musharakah etc).	☐	☐	☐	☐	☐
3.	Assessment on overall market risk is based on integrated views taking into account all products and business lines.	☐	☐	☐	☐	☐
4.	Effective internal controls are in place (e.g. adherence to lines of authority and responsibility) to manage market risk.	☐	☐	☐	☐	☐
5.	IT implementation and maintenance is adequate.	☐	☐	☐	☐	☐
6.	Procedural guidelines and policy documents are aligned with the board's directions.	☐	☐	☐	☐	☐
7.	The bank:					
	a) employs appropriate risk measurement techniques that suit the nature, size, and complexity of the business and the availability of data.	☐	☐	☐	☐	☐
	b) ensures that accurate and timely measurements of market risk are performed.	☐	☐	☐	☐	☐
8.	The risk measurement system:					
	a) is responsive and sensitive to the market	☐	☐	☐	☐	☐
	b) assesses all material risk factors associated with a bank's assets, liabilities and off balance sheet positions.	☐	☐	☐	☐	☐
	c) has well-documented assumptions and parameters.	☐	☐	☐	☐	☐
9.	There is a mutual agreement with the bank and Mudarib /Musharakah partners prior to using the valuation methodologies (to assess the impact of their methods used to calculate and allocate profit).	☐	☐	☐	☐	☐
10.	The bank:					
	a) ensures its liquidity risk commensurate with the abilities to have sufficient recourse to Shariah compliant funds to mitigate risks.	☐	☐	☐	☐	☐
	b) examines all assets and liabilities simultaneously on a continuous basis to ensure a proper balance between funds mobilization and their deployment with respect to yield, risk exposure, etc.	☐	☐	☐	☐	☐

	c) ensures its tolerance levels on mismatches are timely fixed (for various maturities depending on asset liability profile etc).	☐	☐	☐	☐	☐

OPERATIONAL RISK						
No.	**Statement**	**SD**	**D**	**N**	**A**	**SA**
1.	Key risk indicators (KRIs) are reviewed regularly.	☐	☐	☐	☐	☐
2.	The bank has an IT system to:					
	a) accommodate to the bank's business operations.	☐	☐	☐	☐	☐
	b) provide adequate check and balance to ensure that controls are in place.	☐	☐	☐	☐	☐
	c) cater for internal risk reporting and decision making.	☐	☐	☐	☐	☐
3.	The bank reduces operational risks by identifying potential negative events and developing appropriate responses.	☐	☐	☐	☐	☐
4.	Human resources in risk department are adequate and well-trained.	☐	☐	☐	☐	☐

SHARIAH RISK						
No.	**Statement**	**SD**	**D**	**N**	**A**	**SA**
1.	The bank is aware of the potential associated risk to society and the environment (such as its impact on environment, society, financial conditions and operations).	☐	☐	☐	☐	☐
2.	The bank takes appropriate steps to address the above-mentioned risks (include disclosure of information) before underwriting deals.	☐	☐	☐	☐	☐
3.	The bank assesses the potential impacts of its methods with regards to profit (i.e. in terms of its calculations allocations.)	☐	☐	☐	☐	☐
4.	The bank ensures fund providers' interests are taken care off.	☐	☐	☐	☐	☐
5.	The methods used are mutually agreed between the bank and other stakeholders.	☐	☐	☐	☐	☐
6.	The bank donates the penalty charges to charity to comply with Shariah.	☐	☐	☐	☐	☐

APPENDIX 2: WORKSHEET FOR ANNUAL REPORTS

Bank:
Region:

Category	No	Questions	Y1	Y2	Y3	Y4
Mission	1	The text of the board's written mandate is described.	**0**	**0**	**0**	**0**
	2	The bank has a clear statement of the leadership, purpose, mission and values with reference to corporate governance.	**0**	**0**	**0**	**0**
	3	The annual statement contains statement addressing corporate governance.	**0**	**0**	**0**	**0**
	4	Reference is made to widely accept corporate governance principles.	**0**	**0**	**0**	**0**
	5	Assessment is made regarding current compliance (where relevant) with the mentioned CG principles.	**0**	**0**	**0**	**0**
	6	Clear statement of the stakeholders' engagement on corporate governance issues and processes is provided.	**0**	**0**	**0**	**0**
	7	Communication policy for promoting effective communication with shareholders to encourage their participation is disclosed.	**0**	**0**	**0**	**0**
Composition of the Board of Directors	8	Identity of the chairman is provided (such as independent or non-executive, etc.).	**0**	**0**	**0**	**0**
	9	Profile of chairman is disclosed (qualification and experience).	**0**	**0**	**0**	**0**
	10	Proportions of non-executive members or proportions of independent members are provided.	**0**	**0**	**0**	**0**
	11	The identity of each director whether he/she is independent or non-executive is disclosed.	**0**	**0**	**0**	**0**
	12	Profile of each board member is disclosed (qualification, experience etc.).	**0**	**0**	**0**	**0**
	13	A leadership statement on how the board operates is disclosed.	**0**	**0**	**0**	**0**
	14	The Board member's formally assigned individual's responsibilities outside the bank are provided.	**0**	**0**	**0**	**0**
	15	Statement on whether or not the board and its committees are regularly assessed with respect to their effectiveness and contribution is provided.	**0**	**0**	**0**	**0**
	16	If assessments are regularly conducted, the process used for the assessments is described OR if assessments are not regularly conducted, statements on how the board satisfies itself (whether its members and committees are performing effectively) are described.	**0**	**0**	**0**	**0**
Board Leadership	17	Reference to transparent and responsive process for evaluating performance of senior management is provided.	**0**	**0**	**0**	**0**
	18	The way the board delineates its role and responsibilities is described.	**0**	**0**	**0**	**0**

Category	No	Questions	Y1	Y2	Y3	Y4
	19	How the board facilitates its exercise of independent judgment in carrying out its responsibilities is disclosed.	**0**	**0**	**0**	**0**
Board Meetings	20	The number or frequency of the meetings is disclosed.	**0**	**0**	**0**	**0**
	21	Members' attendance at meetings is disclosed.	**0**	**0**	**0**	**0**
Nomination Committee or / and Compensation Committee	22	Committee size is disclosed.	**0**	**0**	**0**	**0**
	23	Identity of the chairperson is disclosed whether he is independent or non-executive.	**0**	**0**	**0**	**0**
	24	Profile of the chairperson is disclosed such as qualification, experience etc.	**0**	**0**	**0**	**0**
	25	Profile of each board member is disclosed.	**0**	**0**	**0**	**0**
	26	Whether or not the board has a compensation committee composed entirely of independent directors is disclosed.	**0**	**0**	**0**	**0**
	27	The proportion of independent members or non-executive members is disclosed.	**0**	**0**	**0**	**0**
	28	The process by which the board identifies new candidates for board nomination is described.	**0**	**0**	**0**	**0**
	29	The process by which the board determines the compensation for the bank's directors and management is described.	**0**	**0**	**0**	**0**
	30	If the board has standing committees other than the audit, compensation & nominating committees, the committees and their functions are disclosed.	**0**	**0**	**0**	**0**
	31	Number of meetings held during the year is disclosed.	**0**	**0**	**0**	**0**
	32	Attendance of each member's committee meetings is disclosed.	**0**	**0**	**0**	**0**
Shariah Governance	33	Statement on the endorsed conformity of Shariah compliance is disclosed.	**0**	**0**	**0**	**0**
	34	Shariah supervisor structure is disclosed.	**0**	**0**	**0**	**0**
	35	The board size is disclosed.	**0**	**0**	**0**	**0**
	36	Identity of the chairman of the Shariah board is disclosed (experience, qualification etc.).	**0**	**0**	**0**	**0**
	37	The chairman of the Shariah board whether he is independent or non-executive chairperson is disclosed.	**0**	**0**	**0**	**0**
	38	Whether other Shariah supervisory board members are independent or non-executive are disclosed.	**0**	**0**	**0**	**0**
	39	Qualification and relevant experience of all Shariah board are disclosed.	**0**	**0**	**0**	**0**
	40	Formally assigned individual's responsibilities of the board (outside the bank) are disclosed.	**0**	**0**	**0**	**0**
	41	How the Shariah board facilitates its exercise of independent judgment in carrying out its responsibilities is disclosed.	**0**	**0**	**0**	**0**
	42	Policies and procedures on appointment and dismissal of members are described.	**0**	**0**	**0**	**0**
	43	Number of meetings during the year is disclosed.	**0**	**0**	**0**	**0**
	44	Members' attendance at meetings is disclosed.	**0**	**0**	**0**	**0**

Category	No	Questions	Y1	Y2	Y3	Y4
Shariah Compliance, Supports and Operations	45	Mechanism on Shariah compliance monitoring is disclosed.	**0**	**0**	**0**	**0**
	46	Treatment of all earnings realized from sources prohibited by Shariah is provided.	**0**	**0**	**0**	**0**
	47	Sources and uses of zakah and charity funds are disclosed.	**0**	**0**	**0**	**0**
	48	Method of zakah calculation is disclosed.	**0**	**0**	**0**	**0**
	49	The contractual rights of investment account holders are disclosed.	**0**	**0**	**0**	**0**
	50	Investment and asset allocation strategies are provided.	**0**	**0**	**0**	**0**
	51	Rights and liabilities of IAH in the event of liquidation are disclosed.	**0**	**0**	**0**	**0**
	52	Statement on the mechanics of smoothing the returns by the bank is provided.	**0**	**0**	**0**	**0**
	53	Notes related to the utilization of profit equalization ratio (PER) is provided.	**0**	**0**	**0**	**0**
	54	Notes related to the utilization of investment risk reserves (IRR) is provided.	**0**	**0**	**0**	**0**
	55	The treatment for the distribution of PER in the event of liquidation is disclosed.	**0**	**0**	**0**	**0**
	56	The profit calculation method and its share of profit earned attributable to IAH are disclosed.	**0**	**0**	**0**	**0**
	57	Changes to policy with regards to profit calculation is provided.	**0**	**0**	**0**	**0**
	58	Changes to policy with regards to investment and asset allocation strategies is provided.	**0**	**0**	**0**	**0**
	59	Change to policy with regards to smoothing of returns	**0**	**0**	**0**	**0**
	60	Legal right due to unrestricted IAH pertaining comingled funds is disclosed	**0**	**0**	**0**	**0**
	61	Legal right due to unrestricted IAH pertaining Mudharib's failure is disclosed.	**0**	**0**	**0**	**0**
	62	A report on appropriateness of Shariah basis of allocation of profit between equity holders and IAH is provided.	**0**	**0**	**0**	**0**
Ethical Business Conduct and Corporate Responsibility	63	The code of ethics for the directors adopted by the board is disclosed.	**0**	**0**	**0**	**0**
	64	If the board has adopted a written code, how a person or company may obtain a copy of the code is disclosed.	**0**	**0**	**0**	**0**
	65	How the board monitors compliance with its code is disclosed OR if the board does not monitor compliance, how the board satisfies itself regarding compliance with its code is described.	**0**	**0**	**0**	**0**
	66	Any steps the board takes to ensure directors exercise independent judgment in considering transactions and agreements in respect of which a director or executive management have a material interest are described.	**0**	**0**	**0**	**0**
	67	Any other step the board takes to encourage and promote a culture of ethical business conduct is described.	**0**	**0**	**0**	**0**

Category	No	Questions	Y1	Y2	Y3	Y4
	68	Mechanism protecting the rights of shareholders is disclosed.	**0**	**0**	**0**	**0**
	69	Policy and performance in connection with environmental and social responsibility is provided.	**0**	**0**	**0**	**0**
	70	Waivers to the ethics code are disclosed.	**0**	**0**	**0**	**0**
	71	Code of ethics for all employees is provided.	**0**	**0**	**0**	**0**
	72	Role of employees in corporate governance is provided.	**0**	**0**	**0**	**0**
	73	Performance evaluation process is disclosed.	**0**	**0**	**0**	**0**
	74	Impact of environmental and social responsibility policies on bank's sustainability is disclosed.	**0**	**0**	**0**	**0**
	75	Policy on whistle blower protection for all employees is provided.	**0**	**0**	**0**	**0**
Audit Committee	76	Committee size is disclosed.	**0**	**0**	**0**	**0**
	77	Identity of the chairperson is disclosed.	**0**	**0**	**0**	**0**
	78	Whether the chairperson is independent or non-executive is disclosed.	**0**	**0**	**0**	**0**
	79	Whether or not the board composed entirely of independent directors is disclosed	**0**	**0**	**0**	**0**
	80	Proportion of independent members is disclosed.	**0**	**0**	**0**	**0**
	81	Whether committee members include non–executive director is disclosed.	**0**	**0**	**0**	**0**
	82	The process by which the board identifies new candidates for board nomination is described.	**0**	**0**	**0**	**0**
	83	The terms of reference of the committee is formed and approved by the board	**0**	**0**	**0**	**0**
	84	Scope of work and responsibilities is disclosed.	**0**	**0**	**0**	**0**
	85	Term of reference of internal audit is disclosed.	**0**	**0**	**0**	**0**
	86	Board's confidence in independence and integrity of external auditors is provided.	**0**	**0**	**0**	**0**
	87	Process of appointment of external auditor is disclosed.	**0**	**0**	**0**	**0**
	88	Process for interaction with external auditor is disclosed.	**0**	**0**	**0**	**0**
	89	Duration of current external auditors is disclosed.	**0**	**0**	**0**	**0**
	90	Rotation of audit partners is disclosed.	**0**	**0**	**0**	**0**
	91	Proportion of audit/other fees is disclosed.	**0**	**0**	**0**	**0**
	92	Number of meetings held during the year is disclosed.	**0**	**0**	**0**	**0**
	93	Attendance of each member's committee meetings is disclosed.	**0**	**0**	**0**	**0**
	94	The suitability of internal audit is provided (based on experience and qualification)	**0**	**0**	**0**	**0**
	95	The internal audit is said to be conversant with policies and procedures of the bank.	**0**	**0**	**0**	**0**
	96	The effectiveness of IA is stated.	**0**	**0**	**0**	**0**
	97	Related party transactions are placed before audit committee and approved by the board.	**0**	**0**	**0**	**0**
Risk Mgt	98	The board provides risk management oversight.	**0**	**0**	**0**	**0**

Category	No	Questions	Y1	Y2	Y3	Y4
Committee or / and Asset Liquidity Committee (ALCO)	99	Full board is accountable and responsible for overall risk.	**0**	**0**	**0**	**0**
	100	Clear-defined mandate to continuously regulate risk activity is provided.	**0**	**0**	**0**	**0**
	101	Other board risk committees are formed.	**0**	**0**	**0**	**0**
	102	Other board committees are also involved in risk oversight.	**0**	**0**	**0**	**0**
	103	Audit committee is also responsible for risk.	**0**	**0**	**0**	**0**
Risk Management, Control Items and Risk Disclosures	104	Bank's risk management organization is disclosed.	**0**	**0**	**0**	**0**
	105	Senior management commitment in risk management is provided.	**0**	**0**	**0**	**0**
	106	Risk management framework is disclosed	**0**	**0**	**0**	**0**
	107	The top emerging risks that arise from the bank's business models and activities are discussed.	**0**	**0**	**0**	**0**
	108	The bank's risk terminology is provided.	**0**	**0**	**0**	**0**
	109	The bank's strategies or procedures are described.	**0**	**0**	**0**	**0**
	110	The bank's risk culture or its risk appetite is described.	**0**	**0**	**0**	**0**
	111	The use of stress testing or other measures is described.	**0**	**0**	**0**	**0**
	112	How the bank plans to meet regulatory ratios is provided.	**0**	**0**	**0**	**0**
	113	All risk information is presented together in a report OR a navigator index to locate the risk disclosure in the reports is provided.	**0**	**0**	**0**	**0**
Reporting - Accounting & Funding	114	The bank has an understanding of internal controls and procedures for financial reporting.	**0**	**0**	**0**	**0**
	115	The board's accountability of the financial statements is disclosed.	**0**	**0**	**0**	**0**
	116	Statement of accounting in compliance in accordance to IFRS.	**0**	**0**	**0**	**0**
	117	Statement on transparency and disclosure is provided	**0**	**0**	**0**	**0**
	118	Statement stressing on Comprehensiveness of Policies and procedures is provided.	**0**	**0**	**0**	**0**
	119	Assets tabulated in balance sheet categories which include collateral received are provided.	**0**	**0**	**0**	**0**
	120	Consolidated total assets, liabilities and off-balance sheet commitments by the remaining contractual maturity at the balance sheet date are presented.	**0**	**0**	**0**	**0**
	121	A narrative discussion of management's approach to determine the behavioural characteristics of financial assets and liabilities is provided.	**0**	**0**	**0**	**0**
	122	The bank's funding strategy, including key sources and any funding concentrations is discussed.	**0**	**0**	**0**	**0**
Market & Liquidity Risks	123	How market liquidity is considered is disclosed.	**0**	**0**	**0**	**0**
	124	How bank manages its liquidity needs is described.	**0**	**0**	**0**	**0**
	125	The linkages between line items in balance sheet and income statement are provided.	**0**	**0**	**0**	**0**

Category	No	Questions	Y1	Y2	Y3	Y4
	126	Qualitative and quantitative breakdowns of significant trading and non-trading market risk factors that may be relevant to the bank's portfolio are provided.	**0**	**0**	**0**	**0**
	127	Qualitative and quantitative disclosures that described significant market risk are provided (such as measurement, model limitations, assumptions, validation procedures, use of proxies, changes in risk measures and models through time).	**0**	**0**	**0**	**0**
	128	The primary risk management techniques to measure and assess the risk of loss beyond reported risk measures and parameters are described (such as VaR, earnings or economic value scenario results through methods such as stress tests, expected shortfall, economic capital, scenario analysis, stressed VaR or other alternative approaches).	**0**	**0**	**0**	**0**
Credit Risk	129	Information on the bank's credit risk profile which includes any significant risk concentration is provided.	**0**	**0**	**0**	**0**
	130	Policies for identifying impaired loans are described.	**0**	**0**	**0**	**0**
	131	Reconciliation of the opening and closing balances of impaired loans are provided.	**0**	**0**	**0**	**0**
	132	A qualitative and quantitative analysis of the bank's counterparty risks that arises from its derivatives transactions is provided.	**0**	**0**	**0**	**0**
	133	Qualitative information on credit risk mitigation is provided.	**0**	**0**	**0**	**0**
Other Risks	134	Other risks types identified by the management are described.	**0**	**0**	**0**	**0**
	135	How they are identified, governed, measured and managed is disclosed.	**0**	**0**	**0**	**0**

APPENDIX 3: LIST OF ISLAMIC BANKS[51]

No.	Country	No.	Bank	No.	Country	No.	Bank
1	Bahrain	1	ABIB	9	Pakistan	29	Al-Falah
		2	Bahrain Islam.			30	Meezan
		3	As-Salam			31	Bujr (Daw.)
		4	Khaleeji	10	Qatar	32	QIB
		5	Ithmaar			33	Rayan
		6	Eskan			34	IBQ
		7	ABCIB			35	QIIB
		8	Capinnova			36	QNB
		9	KFH	11	Saudi Arabia	37	AlRajhi
2	Bangladesh	10	S.Jalal			38	AlJazira
		11	Islami			39	AlInma
		12	Al-Arafah			40	Jadwa
3	Egypt	13	Faisal			41	Riyadh
		14	Albaraka	12	Sudan	42	Al-Shamal
4	Indonesia	15	Muamalat			43	Albaraka
		16	BSM (Sy.M.)			44	Faisal
		17	BNI Syariah	13	Turkey	45	Albaraka
5	Jordan	18	JIB			46	Asya
		19	IIAB			47	KuveytTurk
		20	JDIB	14	UAE	48	ADIB (A.Dh)
6	Kuwait	21	Boubyan			49	DIB (Dubai)
		22	Kuwait Intern.			50	Hilal
7	Malaysia	23	BIMB			51	Emirates Isl.
		24	CIMB			52	SIB
		25	RHB	15	UK	53	Gatehouse
		26	Affin			54	BLME
		27	HL			55	IBB
8	Oman	28	BMI			56	EIIB
				16	Yemen	57	Tadamon

[51] To expand the sample size, non-IBs offering Islamic products are also included.

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